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## H.R. 4882, TO AMEND THE CONGRESSIONAL BUDGET ACT OF 1974

WEDNESDAY, DECEMBER 9, 1981

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON RULES,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10 a.m., in room H-313, the Capitol, Hon. Gillis W. Long presiding.

Present: Representatives Pepper, Long, Zeferetti, Derrick, Beilenson, Frost, Bonior, Latta, Rhodes, and Bolling.

Mr. LONG. The committee will come to order.

The hearings this morning are on H.R. 4882. In essence, this legislation would require that each congressional budget resolution fix the level of tax expenditures for the fiscal year involved as well as the recommended aggregate of Federal revenue.

Our first witness this morning is the principal author of this legislation, Hon. David E. Bonior, of Michigan.

David, we welcome you here. I would recommend that the committee take a 5-minute recess so that we can make that rollcall vote, rather than interrupt your testimony, and we will proceed at about 10 minutes after 10.

The committee stands in recess.

[A brief recess was taken.]

Mr. LONG. The committee will come to order.

Mr. Bonior, will you proceed?

### STATEMENT OF HON. DAVID E. BONIOR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. BONIOR. Mr. Chairman, the issue here today is tax expenditures. If you mention that term as an important economic issue at a town hall meeting in your district, you will probably receive more blank stares than nods of assent. However, if you mention tax loopholes or preferential tax treatment, most people can bring to mind one or two which particularly incense them. Although most taxpayers have used tax expenditures at one time or another, loopholes are always looked upon as those tax expenditures used by other people.

In any case, tax expenditures are basically tax reducers in their most neutral terminology, special provisions in law outside of the normal tax structure which reduce the amount of taxes paid by individuals or corporations.

These special provisions can take the form of tax credits, preferential rates of tax, exclusions, exemptions, or deductions from gross

income. They are designed to reduce a tax burden or encourage a particular economic behavior. Given the strange manner in which this body conducts its business at times, it is not unusual to find that they are available to the flatulently wealthy as well as the abject poor.

In my testimony this morning, I would like to raise several points which subsequent expert witnesses can elaborate on.

First, tax expenditures have an enormous impact on the budget and affect virtually all Americans.

Second, tax expenditures are growing at a faster rate than direct expenditures and bear great potential for subverting the budget and legislative process. I think the chart to my right illustrates that point quite well.

Third, although we continue to use tax expenditures as a fiscal tool, little sophisticated knowledge exists concerning the precise measurement of their aggregate costs or of their economic effects individually or synergistically.

Fourth, the tax expenditure configuration as it now exists should not be assumed to be either rational or equitable.

There is nothing mystical in the term "tax expenditure." It merely refers to an article of law which decreases the amount of taxes a corporation or individual would pay in its absence.

Unfortunately, the Congress and those who administer its tax laws have consistently shown an affinity for producing tax formulas with the conceptual complexity of an Escher rendering and the bewildering verbiage of an advanced physics text.

Nevertheless, their end effect is simple: They reduce the tax responsibility for a particular group of people or businesses.

In modifying the tax responsibility for the particular, they affect the tax responsibility of the aggregate. Each year, the Congress decides which Federal services are essential and at what level they will be funded. Obviously, a similar level of revenues must be collected to fund those activities. The continuation or enactment of tax expenditures, while lowering the tax burden of some, raises it for the whole or at least maintains it at a higher level than it would be in the absence of tax expenditures. Thus, tax expenditures affect all taxpayers regardless of their intended effect.

The aggregate cost of tax expenditures, estimated at \$266 billion for fiscal year 1982, represents an enormous involvement in particular economic activity and yet are not directly controlled through the budget resolutions as are direct expenditures and revenues.

This further diminishes the already minor portion of Federal economic activity that Congress is able to affect each year. In fact, as Dr. Alice Rivlin of the Congressional Budget Office stated before this committee in 1980, when you eliminate tax expenditures and other uncontrollables in Federal fiscal policy, the Congress basically works with 30 percent of the Federal budget each year. As we have seen this year, the existence of that condition has disastrous budgetary consequences for those programs the Congress does control.

Second, the annual growth rate of tax expenditures exceeds that of direct expenditures. Since 1975, tax expenditures have increased at an average rate of 14 percent, compared to 11 percent for direct expenditures.

In 1967, there were some 50 tax expenditure programs representing a total revenue loss of \$36 billion. In 1982, there will be 104, representing a total revenue loss of \$266 billion and that figure is expected to climb to \$465 billion by 1986. The Tax Incentive Act of 1981 alone created 8 new tax expenditures, expanded 22 others, and eliminated only 2.

Even more impressive, however, is the fact that in some functions of the Federal budget, such as energy and housing, tax expenditures actually exceed Federal outlays or direct expenditures.

This trend can be expected to continue and even accelerate as Congress places heavier emphasis on controlling direct expenditures.

The fact that tax expenditures are not subject to the appropriations process and rarely to reauthorization makes them all the more attractive to their proponents although they undermine the legislative process and remove additional Federal activities from direct budgetary control.

Third, the impreciseness with which we define tax expenditures and measure their overall costs has to be a bit unsettling for those who are conscientious about managing the budget.

Designation as a tax expenditure at times seems more than a bit arbitrary. For example, a deduction for investment in capital equipment is considered a tax expenditure while business entertainment costs are not.

Furthermore, most tax expenditure experts would agree with a 1979 GAO report which stated: "The cost of all tax expenditures is the difference between the revenue raised by normal tax structure and that raised by the existing structure. In the real world, these costs cannot be determined directly."

Changing economic conditions and the synergistic effects of tax expenditures with each other or with direct spending programs mandates that any aggregate estimate be accompanied by a strong caveat concerning its accuracy.

Greater time and resources must be devoted to constructing sophisticated, consistent measurement formulae. Because we have allowed tax expenditures to multiply unfettered in the past, no urgency has existed until now to do so. That situation would change with the passage of H.R. 4882.

Finally, our portfolio of tax expenditures should not be considered particularly rational or particularly equitable.

For instance, there is no apparent reason why coal or timber royalties should be taxed as capital gains rather than at the higher normal rate as income.

Further, those earning over \$50,000 per year—5.6 percent of all taxpayers—are overrepresented in the utilization of some of our costliest tax expenditures. This 5 percent represents 83 percent of all claims for capital gains exclusion, 46 percent for consumer interest deductions, and 31 percent for home mortgage interest tax deductions. A 1980 Library of Congress report states, " \* \* \* in fiscal year 1978, the greatest absolute benefit from tax expenditures went to the highest income group, over \$50,000."

Perhaps the Congress would not change those priorities even if it had the opportunity. The point is that when the Congress yearly



struggles through the setting of national priorities, tax expenditures should also bear the regular scrutiny of that process.

If the Congress were to permit itself that direct scrutiny, I cannot believe that Americans would allow it to reduce low-income energy assistance—an action which condemns many of our elderly to shiver in the darkness of their own homes, while a company such as Burlington Northern with a net income of \$223 million, not only pays no taxes because of tax expenditures, but claims an additional \$36 million from the Treasury through the sale-leaseback provisions of the Tax Incentive Act of 1981.

Can we not agree, regardless of political or ideological persuasion, that there is something basically inequitable in a budget system that provides a mere \$5 per week tax reduction for a single-earner family of four earning under \$20,000, that asks our senior citizens to give up social security benefits, that deprives children of feeding programs, that tells the handicapped to make it on their own, and allows some of our wealthiest corporations to pay zero income taxes because of the tax expenditures we refuse to review or to touch?

In the now famous article from the December 1981 Atlantic Monthly, Mr. Stockman claims that his "Chapter II" was intended to eliminate certain tax loopholes to balance the inequity of the extensive cuts in social programs. The President rejected that proposal and what we ended up with was a reform that allows profitable companies to not only avoid all taxation but to actually claim millions more from the Treasury. In Mr. Stockman's own words, "The hogs were really feeding."

To await the administration's tax expenditure reforms, 10 months after they were promised, is to anticipate a larger trough with an expanded guest list. On November 29, Secretary Regan unabashedly told America, " \* \* \* we are rather proud of—the sale-leaseback provision." So much for reform.

My bill, H.R. 4882, would amend the Budget Act to require that ceilings for tax expenditures be included in the first and second resolutions in addition to the ceilings now required for direct expenditures and the floors required for revenues. It will afford Congress another significant tool in its efforts to move in the direction of a balanced budget, to clearly establish priorities in that pursuit, and to display those priorities for public review.

Bipartisan support for control of tax expenditures was exhibited in hearings held in the Senate on November 24 of this year. Unfortunately, the administration was not able to produce a witness for those hearings or these, and the world still awaits chapter II. Obviously, that chapter is being somewhat more leisurely written than was the chapter on elimination of the social security minimum benefit.

Many of the people that I have spoken with concerning this reform have agreed in principle with its thrust, which calls to mind Bismarck's statement that, "When you say that you agree to a thing in principle, you mean that you have not the slightest intention of carrying it out in practice." I hope that such is not the case in this instance. I think it is obvious to most that the congressional budget process must be reformed. We affect the comfort and wel-

fare of all of our citizens through that process and it is incumbent that we act expeditiously to avoid a repeat of this year's mayhem.

In any case, I am grateful to the chairman for conducting these hearings and it would be my hope that they will be the first in a series of hearings on various budget reform proposals.

Mr. LONG. Thank you, Mr. Bonior.

Looking at the political realities, you know that a number of people, including even the members of this committee, are unwilling to admit the validity of the term, tax expenditure, though it is a legitimate financial term.

Do you see any chance of building the necessary political constituency? I think some support for the general proposal of control of tax expenditures is going to be required before we can get any effective momentum to consider it in the budgetary process.

Mr. BONIOR. I understand the difficulty some people have with the terminology, but I would respond by saying that it is part of law. It was included, of course, in the Budget Act of 1974, and it is an issue that, it seems, has to be faced by the Congress. I think the chart to my right illustrates the fact that if we don't address it as a concept, we are going to find ourselves with even deeper deficit problems than we already find ourselves with today.

The other point I would make with respect to that comment is that tax expenditures are indeed a significant part of the budget, roughly 25 percent if you consider the cost, \$266 billion this year and reaching \$465 billion in 1986. And it seems to me that they ought to be under review and scrutiny just as any other direct spending program.

The fact of the matter is that Ways and Means, for instance, has reviewed only, I believe, last year 10 of the 104 tax expenditure programs that we have.

And politically, I think, to answer the first part of your comment or question, I think it is possible. We have seen recently the number of Senators taking this issue very seriously. Senator Domenici in the Senate is one who has expressed an interest in doing something about it, as well as Senator Kassebaum, and I would suspect before long the administration will be before the Congress asking us to at least take a look at it in a serious way, because we can't continue with the deficits as they are now, approaching enormous proportions.

Mr. LONG. The committee has a request that photographs be allowed. Unless there is objection, it is so ordered.

Has anyone done any studies to see if there's a correlation between the amounts individuals receive from tax expenditures and direct spending and the recipients' tax brackets?

I wonder if there are any figures on that. I think all of us would probably assume, as you did in your testimony, that the maximum amount of tax expenditures goes to those in the highest tax brackets. I wonder if there have been any statistical correlations drawn between the amount of the tax expenditure and the income of the recipient?

Mr. BONIOR. There has been a study done by GAO and also by the CRS with respect to the percentage of tax expenditures that go to various income groups—CBO, excuse me. But there has not been a direct correlation, to my knowledge, between direct spending and



tax expenditures and the income groups that they go to. It is obvious, as you suggested and I stated in my testimony, that the highest percentage of tax expenditures goes to that top income group, those who are making over \$50,000, 5.6 percent.

In fact, the tax expenditures over \$5 billion, the large tax expenditures, the real estate deduction, the State and local tax deduction, the home mortgage, the consumer interest deduction, all the big ticket items, capital gains exclusion, charitable deductions, those tax expenditures, deductions and breaks go to higher income groups, although it must be pointed out that there are, for instance, like the child care credit that go to income groups that are in the lower scale of those earning income.

So it is spread out, but obviously the largest proportion goes to those who are making the big dollars in our society. But it would be interesting to find out just exactly how that spread is developed in terms of direct expenditures.

I would think just off the top of my head that it would be a more even curve rather than a curve that we have now for tax expenditures, if you consider direct expenditures.

Mr. LONG. Mr. Latta.

Mr. LATTA. It would be interesting to find out what you mean by tax expenditures as far as the definition is concerned. How far do you want to go on this? Everybody gets something from the Government, would you call every benefit a tax expenditure?

Mr. BONIOR. That is one of the difficulties, trying to measure it. I think what the bill will do, by requiring us to set a ceiling, as far as the second budget resolution, is to help focus some attention on determining what a tax expenditure is, and to develop a little more precision in its labeling.

For instance, before you came in I mentioned in my testimony that one would think that a tax expenditure might include business entertainment cost, three-martini lunch, so-called, but it doesn't.

Mr. LATTA. Why wouldn't it?

Mr. BONIOR. I don't know. I think probably it should, but it is a good question to ask the CBO when they testify before us.

Mr. LATTA. Everybody gets an exemption under the income tax laws. That certainly ought to be included if you are going to talk about tax expenditures. How much does that run to, do you have any idea?

Mr. BONIOR. How much does what run?

Mr. LATTA. The exemption that everybody gets, the \$1,000 off the income tax?

Mr. BONIOR. I don't know. I don't have the figures.

Mr. LATTA. That is a tax expenditure if there ever was one, and everybody gets it who files an income tax return, except people who don't pay any taxes at all.

Mr. BONIOR. But I think that is basically part of the base rate tax structure, as the progressivity of it as part of the base rate. I guess what I am concerned with is the additional measures, precise laws that are put into the tax code to affect certain economic activity in a given sector, rather than in a general sense.

Mr. LATTA. And you mentioned charitable deductions. Certainly you indicated you want to include those?

Mr. BONIOR. They are included under law right now.

Mr. LATTA. Yes.

Mr. BONIOR. And it is a big item. It is \$10 billion.

Mr. LATTA. As soon as you mention tax expenditures, this question is raised immediately: How are churches going to be maintained, and how are these charities going to be maintained? You certainly receive a lot of opposition to your proposal right there.

Mr. BONIOR. I have no doubt about that, but it is not my proposal that wants to eliminate charitable deductions. All my proposal does is suggest that we review the whole scope of tax expenditures when we deal with the budget, which we don't do today.

Now, I am not endorsing any of the 104 tax expenditures that are presently on the books, but I am suggesting that we look at each one of those, and determine whether they are really affecting the economic activity or behavior that they were intended to affect, and whether they are worth continuing, and whether, measured against the reductions that we have made in direct spending through the budget process, they ought not to be dealt with in a same equitable manner.

Mr. LATTA. Doesn't Ways and Means have some kind of ongoing subcommittee which looks at these things?

Mr. BONIOR. Ways and Means does, but you know that committee is burdened with a tremendous workload and a large scope in terms of issues. The 96th Congress Ways and Means activity report shows specific oversight on maybe 10 of the 104 programs, and I can't fault Ways and Means entirely, because they have a heavy load to deal with, but I am suggesting that we in the Congress as a unit ought to share that responsibility, and ought to provide some means for Ways and Means to look at more than just 10 of these programs through the budget process.

Mr. LATTA. I can see a shifting of responsibility from Ways and Means to the Budget Committee. We have all we can handle with the shifting of the debt ceiling, which I thought ought to remain with Ways and Means. You have a lot of problems and a short time to deal with them. Now they are talking of a 2-year budget. That idea is being floated around, and it is because of the fact that we are trying to pack into 365 days an awful lot of work.

I quite agree that these things all seem to be getting out of bounds, there isn't any question about it. The first thing you have to establish is a definition of what you mean by tax expenditures so that you know what you are dealing with. That is all.

Mr. LONG. Mr. Beilenson.

Mr. BEILENSEN. Thank you, Mr. Chairman.

I would just like to say that I think your statement is excellent, and I certainly agree with it in principle—I also think I am a cosponsor. It is fair to say, too, that all of the objections or questions that were raised by Mr. Latta with respect to these things can also be raised with respect to direct tax expenditures by the Federal Government. You can raise all of these same questions.

He asked whether or not Ways and Means has ongoing authority to look at these particular things. Obviously, all of the other policy committees have ongoing authority to look at all of the programs we are spending money directly for over the year, so the exact same arguments that can be made against this or against or for

this can be made for the other. There is no difference in my mind. They are in fact expenditures by the Federal Government. They in fact have a great deal to do with the size of our budget deficits each year.

With respect to definition, you can always raise that problem. I am sure there are some definitional problems which are difficult of solution, but there are already definitions, including one in the Budget Act of the CBO report in September. It begins by talking about definitions: "Tax expenditures are revenue losses that arise from provisions of the Tax Code that give special or selected tax relief to special groups of taxpayers." It refers to the Budget Act, "those losses attributable to provisions of the Federal tax laws which allow a special exclusion exemption or deduction from gross income or which provide a special credit preferential rate of tax or deferral from tax liability."

There are 104 tax expenditures, and we know what they are. We can debate and add or subtract from them, and nobody is suggesting—least of all Mr. Bonior—that they should be done away with. He is simply saying that along with direct expenditures of the Federal budget, they can be included in the Federal budget resolution, so we can make some decisions to see what we are spending and to slow down the rate of growth—exactly the same kinds of things we are in the process of doing now with direct governmental expenditures.

There is no difference. You can make all the suggested arguments on either side of the question. For people who are seriously concerned, and I am sure all members of the Budget Committee are, and all Members of the House are, about limiting growth of the Federal Government, there is no excuse in the world in my opinion for excluding this enormous growth industry which is growing at a rate far greater than direct expenditures.

Obviously, we are going to be stepping on some toes, and obviously a lot of the expenditures aren't going to be repealed. But some of them perhaps should be slowed even as we are starting to grapple with slowing the growth of social security, which is certainly as difficult a thing to do politically as stopping the growth of some of these expenditures, perhaps more so, or even of reducing the defense budget next year. That is a difficult thing to do, too. We have got to look at all of these things. I think, therefore, Mr. Chairman, that this proposal of Mr. Bonior has great merit.

Mr. LONG. Will the gentleman yield? This problem of definition is one that has been attacked in the last few years in the course of trying to identify specific items within—how many of them are there, 104?

Mr. BONIOR. 104.

Mr. LONG. Within the category of tax expenditures. I understand that the Department of the Treasury, the Congressional Budget Office, and the Joint Committee on Taxation have pretty generally agreed as to what fits in that category, with a few exceptions. I think some progress is being made in getting a handle on the problem.

Go ahead, Mr. Beilenson.

Mr. BEILENSEN. I am all through.

Mr. BONIOR. If I can respond to Mr. Beilenson, I think one of the most disturbing points that I alluded to in my testimony is the fact that we are starting to see an acceleration of backdoor spending through this tax expenditure process, and what I mean by that is that everyone understands that the door is shut to direct spending around here, basically shut.

People aren't coming in and asking for new programs, but what is happening is that we are getting an expansion of tax expenditures through Ways and Means. We have had 22 expansions in the last tax bill that we passed last year, 8 new ones. We only eliminated two, and you know that process is far from open.

Ways and Means puts together a tax bill and we put out a rule that is generally pretty well closed, and it is an up or down vote on the House floor without very much review, debate, or discussion, and I think that is a real problem, especially when we have those figures that indicate the direction in which this issue is going.

Mr. BEILENSEN. If I may, Mr. Chairman, I was going to ask about this.

It would be perhaps useful to us, David, if we had a list, if somebody could provide a list of those tax expenditures most prevalent, those just recently enacted.

Mr. BONIOR. I think we would agree on many of them. There are certainly some we would not agree on. I think the leaseback provision is very controversial. We got rid of the marriage penalty. That is a tax expenditure, and perhaps most of us here would probably agree with that one, but some of us may not.

Mr. BEILENSEN. But it would be useful nonetheless?

Mr. BONIOR. It sure would.

Mr. BEILENSEN. It might as well be done just for this year in terms of indicating new ones and expanding 22 others and how much money it is costing us. Maybe your people could provide that for us?

Mr. BONIOR. The list is in the packet, I have been told. It is in this book.

Mr. BEILENSEN. I am not sure they were set out separately, though, in that particular CBO report.

Mr. BONIOR. On page 72. [See p. 92 of this publication.]

Mr. BEILENSEN. Thank you very much.

Mr. LONG. Mr. Rhodes.

Mr. RHODES. Mr. Chairman, thank you. I want to thank our colleague from Michigan for this statement. It is extremely well done and sets forth his viewpoint I think very clearly. I am sure it is no surprise to my friend that I don't agree with a lot of it, but nevertheless I do think it is an important subject that needs scrutiny and attention by the Congress.

I have got to admit that I have a philosophical problem with the word "tax expenditures." That seems to imply that the income, which is the subject of the tax, doesn't belong to the individual who earned it but belongs to the Government from its very inception. That if you give part of it back to the one who earned it, that you are somehow or other depriving the Government of something which was the Government's, and I just don't happen to go along with that, but that is more philosophical than real.



I think as far as the actual use of tax expenditures—I will use the term although I don't like it—is concerned, I think that you probably would agree with me that they were put into being, each of them, probably for one of three reasons: to accomplish an economic purpose that the majority of Congress believed was necessary, or to accomplish a social purpose which the Congress believed to be necessary, or for a reason which would be, I think, less laudable, and that is the mere fact that there was a very important segment of the population that wanted this tax advantage and had the muscle to get it, and those I think are probably the three reasons for the existence.

Now I would, without being able to quantify each one, hope that most of the so-called tax expenditures came from the first two motives rather than the last, but recognizing that there could be all three involved.

When you get right down to it, I suppose you could say that the progressive income tax is in a way a tax expenditure, because it isn't equal. It takes from the earnings of some more than it does the earnings of others, but it accomplishes a social purpose which the Congress at that time and the people, when they passed the 16th amendment, the income tax amendment, thought was important and necessary, and it served the country rather well.

What I believe you are saying is that the system has become so overweighted in the composite that it is actually impinging on the effectiveness of the entire revenue structure, and I am not sure but what that is a correct assumption. I think there are some studies that need to be made.

Mr. BONIOR. I would respond by thanking you for your observations, and I would agree that the three categories that you have just mentioned in terms of why these expenditures were put into law, are probably correct. I would go even further and suggest that most of them have served a good purpose, and have benefited society in general.

My point in the bill, though, as I mentioned several times now, is just to get a review process, in order that we can examine tax expenditures to make sure that they are not antiquated, for instance, or that they are not producing the opposite of what they were intended to produce for society. That is what we are interested in.

Mr. RHODES. One of the so-called tax expenditures which has been under attack for some years is the deduction for mortgage interest payments, and of course I don't intend to single that out necessarily, except to show that there is a real difference of opinion as to the efficacy and fairness of many of these so-called tax expenditures. I happen to think that when a person buys a house and expects to have the interest payments deducted, that the Government has sort of made an agreement with him that that will last.

Mr. BONIOR. Oh, sure.

Mr. RHODES. And that changing that during the term of the mortgage would be a definite breach of faith.

Mr. BONIOR. I agree entirely. It is somewhat like—I don't mean to be partisan—something like changing social security overnight for people who expected to get their early retirement. Maybe we have to do that eventually, I don't know, but I think you have to give people due notice on something like that.

Mr. RHODES. Right.

Mr. BONIOR. But you know there are real questions about people who have a second or third home, whether the total interest there should be deducted, or whether we should put a cap on the amount of interest. That ought to be examined, it seems to me.

Mr. RHODES. Of course, I think your point on social security is a little bit different, because all of the benefits which we now get from social security, most of it comes from an increase, and most of the people who entered the system some years ago entered it at a much lower level of benefit. I mean the benefits to those who were receiving social security at the time that the worker entered the work force were much lower, and therefore his expectations are probably lower than his present eligibility for benefits.

Mr. BONIOR. That is true.

Mr. RHODES. I think that that problem is not precisely a good analogy.

Mr. Chairman, I think that these are subjects that need to be explored.

Mr. LONG. Thank you, Mr. Bonior. Do you have anything else to add?

Mr. BONIOR. Thank you, Mr. Chairman.

Mr. LONG. Thank you for testifying.

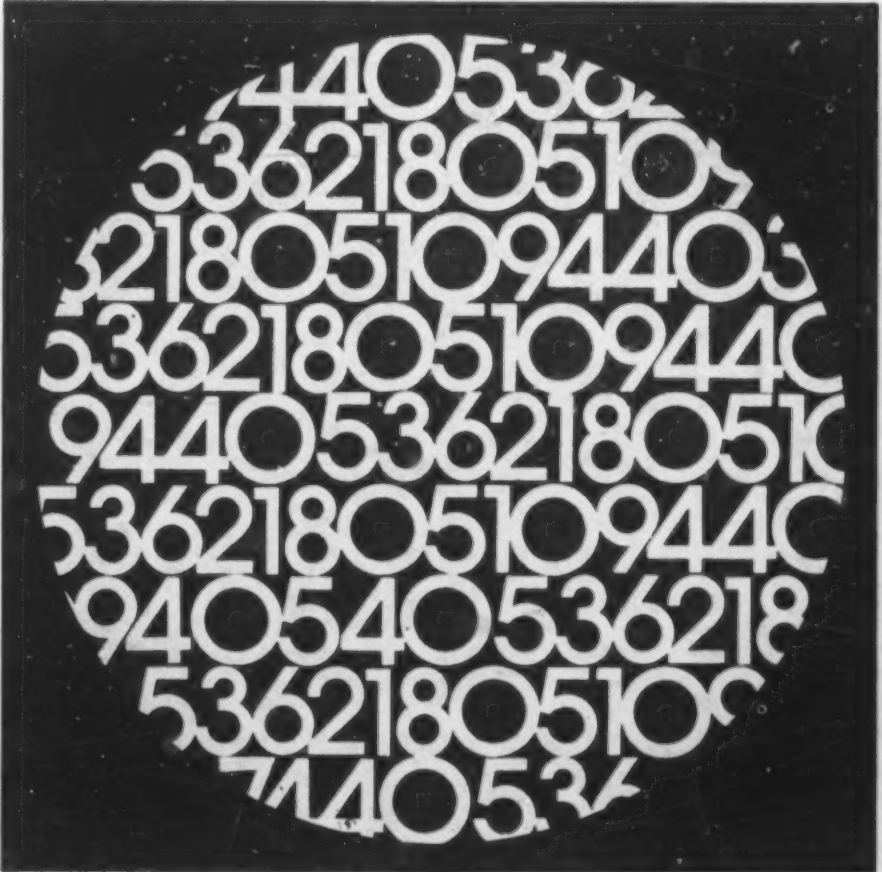
[The CBO report referred to by Mr. Bonior follows:]

September 1981

# TAX EXPENDITURES: CURRENT ISSUES AND FIVE-YEAR BUDGET PROJECTIONS FOR FISCAL YEARS 1982-1986

A CBO Report

As Required by Public Law 93-344



CONGRESS OF THE UNITED STATES



CONGRESSIONAL BUDGET OFFICE

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PREFACE

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The Congressional Budget Office is required by section 308(c) of the Congressional Budget Act of 1974 to issue a report each year that projects tax expenditures for each of the next five fiscal years. This report fulfills that statutory requirement for fiscal years 1982 to 1986. It is a companion to Baseline Budget Projections: Fiscal Years 1982-1986 (July 1981), which gives CBO's projections of budget authority, outlays, and revenues for the same period.

This report also discusses a number of definitional and measurement issues that have arisen with respect to tax expenditures, and reviews some of the economic, jurisdictional, budgetary, and administrative considerations in choosing among tax expenditure subsidies, general tax cuts, and direct expenditure subsidies. It also reviews briefly the legislation affecting tax expenditures enacted in calendar years 1980 and 1981, including the Economic Recovery Tax Act of 1981. The five-year projections of revenue losses from tax expenditures in Appendix A do not include the effects of that act, however; they reflect the law in effect on January 1, 1981.

The report was prepared by James M. Verdier of the Tax Analysis Division, with assistance from Ralph Rector, Willie Bradford, and Martha Campbell. All members of the Tax Analysis Division provided valuable comments and suggestions. A number of others both inside and outside of the CBO made detailed comments on earlier drafts, including Henry Aaron, Albert Buckberg, Sheldon S. Cohen, Seymour Fiekowsky, Alfred B. Fitt, Jerome Kurtz, Paul R. McDaniel, Joseph A. Pechman, Allen Schick, Mark Steitz, Emil M. Sunley, Stanley S. Surrey, and Paul Van de Water. Patricia H. Johnston edited the manuscript, and Linda Brockman typed it.

Alice M. Rivlin  
Director

September 1981



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## SUMMARY

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Tax expenditures are revenue losses that result from provisions of the federal tax code that give special or selective tax relief to certain groups of taxpayers. Like federal spending and loan programs, tax expenditures serve to channel resources from some sectors of the economy to others. The investment tax credit, for example, encourages investment in business plant and equipment by allowing those who make such investments to pay less tax than they otherwise would, while the extra personal exemption for the blind gives special tax relief to this class of taxpayers.

There is occasional uncertainty about whether a particular provision should be treated as a tax expenditure or not. The general rule is that provisions that are part of the normal structure of the income tax--general rate schedules and exemption levels, deductions for the costs of earning taxable income, and the like--are not tax expenditures; only special provisions that have some purpose beyond simply defining taxable net income fall into this category.

## MEASUREMENT

Since tax expenditures represent revenue the federal government does not collect, measuring them presents some special conceptual and practical problems. The amount of revenue that would be collected under some different law can never be directly observed. A tax system without tax expenditures is simply an abstraction; it cannot be measured with the same precision that actual outlays and tax collections can.

In addition to this conceptual problem, practical difficulties arise because of the interaction of the revenue loss estimates of tax expenditures with the standard deduction (zero bracket amount), marginal tax rates, and other provisions of the tax code. The estimates for each tax expenditure are made by assuming that the provision is repealed, that all other provisions of the tax code are unchanged, and that economic behavior is not affected by the tax expenditure change. While this is a convenient and useful approach for estimating the cost of a single tax expenditure, since



it corresponds roughly to the estimates for individual spending programs, it becomes less realistic as more and more simultaneous changes in tax expenditures are included in the estimate. The arithmetic total of all tax expenditure revenue losses thus has only limited value. Nonetheless, the estimates of the revenue loss from each individual tax expenditure serve well the major purpose of the tax expenditure budget, which is to compare the costs and benefits of alternative ways of channeling resources to particular groups or activities.

#### TAX EXPENDITURE SUBSIDIES, GENERAL TAX CUTS, AND DIRECT EXPENDITURE SUBSIDIES

Since the effects of tax expenditures are very similar to those of federal spending and loan programs, it is useful analytically to consider tax expenditures as alternatives to spending programs. In practice, however, the choice is frequently between changes in tax expenditures and more general tax cuts. Changes in tax expenditures are normally considered in the context of tax legislation, and committee jurisdictional constraints generally limit the extent to which trade-offs between tax expenditures and direct spending programs can be made. Trade-offs between tax expenditures and general tax cuts are more feasible. The size of a general tax cut may be reduced to make room for new or increased tax expenditures, while revenue raised from reducing existing tax expenditures can be used to finance a larger general tax cut.

#### Tax Expenditures Versus General Tax Cuts

In deciding between tax expenditures and general tax cuts, the choice is generally between relatively large per-taxpayer savings for a narrowly defined group of taxpayers and relatively small per-taxpayer savings for large numbers of taxpayers. More specifically, the choice may turn on the possible effects of alternatives on taxpayer behavior and marginal tax rates.

Proponents of tax expenditures that encourage or reward a certain kind of behavior--targeted savings incentives, for example--frequently argue that such provisions will have greater effects on taxpayer behavior than broad across-the-board tax cuts of the same overall dollar amount. While tax subsidies or incentives that favor a particular kind of economic activity will result in more resources being devoted to that activity, this usually represents a reallocation of existing resources rather than any

overall increase in resources. The effects on overall economic activity are likely to be about the same as from a general tax cut of the same size.

Tax expenditures can be viewed as both a cause and an effect of high marginal tax rates. Because tax expenditures remove a large share of income from the tax base, tax rates must be higher on the taxable income that is left to raise the same amount of revenue. And because marginal tax rates often reach quite high levels, there is continual pressure for tax expenditures to shield income from those high rates.

#### Tax Expenditures Versus Direct Expenditures

Tax subsidies can also serve as alternatives to spending or loan programs. Almost any feature that is included in a spending or loan program can be duplicated in a tax subsidy. There are some practical differences between tax and direct expenditure subsidies, however, that may lead the Congress to choose one rather than another.

Nontaxpayers. It can be difficult to extend tax subsidies to individuals and businesses that do not pay taxes. The most straightforward way of doing so is through the use of "refundable" tax credits--credits that are paid directly in cash to the recipients if they do not have tax liability as large as the credit. The only tax expenditure that is currently refundable is the earned income credit for low-income workers with dependents, but it has frequently been suggested that the investment tax credit and other business tax credits be refundable as well. Another way of extending tax subsidies to nontaxpaying businesses is through leasing arrangements, whereby a business with little or no tax liability leases equipment from a business with enough taxes to use the subsidy. The rules for this arrangement were considerably liberalized in the Economic Recovery Tax Act of 1981.

Experience with the earned income credit suggests that nontaxpaying individuals, especially those with low incomes, can be more difficult to deal with through the tax system than nontaxpaying businesses. The IRS may have no record of the existence of nontaxpaying individuals, and thus cannot easily inform them of their possible eligibility. Many low-income individuals are fearful of the IRS, and may be reluctant to have any association with it. Even if they overcome their reluctance, they may have difficulty with the forms and paperwork necessary to establish their

eligibility, and the IRS has relatively few resources to provide them with assistance.

Committee Jurisdictions. Tax expenditures come under the jurisdiction of the tax-writing committees, while most spending programs that might be considered as alternatives come under the jurisdiction of other committees. Although this can make it difficult for the Congress to consider directly trade-offs between tax subsidies and spending programs, the problem can be eased by provisions in both Houses for the joint referral of legislation to two or more committees.

The tax committees sometimes lack expertise in program areas in which tax subsidies are provided. These committees do have jurisdiction over a wide range of health, welfare, Social Security, and unemployment compensation programs, however, and have dealt extensively in recent years with energy issues. Joint referral can also help to make up for a lack of tax committee expertise.

Budgetary Control. Tax expenditures are subject to less precise control in the budget process than are most spending programs. The budget resolutions do not set targets for tax expenditures by budget functional categories, as they do for direct spending programs. Nor are the tax committees allocated target ceilings for tax expenditures, as all committees are in the case of spending programs under their jurisdiction.

Revenue floors -- The budget process does impose one very important constraint on tax expenditures, however. Once an overall revenue floor is established by the second budget resolution, any legislation that would reduce total revenues below the floor is subject to a point of order. This requires that any increases in tax expenditures compete with all other revenue-losing provisions for the limited amount of tax reduction that is permitted. This is not very different from the discipline that applies to spending programs. While the second budget resolution does include limits on spending by major functional category, it is only the overall spending totals that are binding, just as it is only the overall revenue floor that limits tax expenditures.

Visibility -- Each bill increasing or reducing tax expenditures is accompanied by a report giving an estimate of the five-year loss or gain from the change, just as spending bills are accompanied by five-year cost estimates. Changes in tax expenditures have the same effect on the federal deficit as do any other

tax or spending changes, and thus receive whatever attention and scrutiny that entails.

Periodic review -- Tax subsidies are not regularly reviewed in the way that spending programs subject to annual appropriations or periodic reauthorizations are. With the growth in recent years of entitlement programs, however, only about half of federal spending is subject to discretionary annual appropriations, and programs that are periodically reauthorized may not receive detailed scrutiny each time. In addition, tax expenditures often come up for review when the Congress considers major tax legislation, which it has done often over the last decade. Some new tax expenditures in recent years have also included scheduled expiration dates and/or required studies of their effectiveness, thereby encouraging periodic review.

#### Administration

The ease of administration of any subsidy program depends mainly on the eligibility rules and how they are enforced. If the rules are clear and simple, if the information needed to verify eligibility can be easily obtained, and if no significant exercise of judgment is required to apply the rules, administration of the subsidy is easy. The more a program departs from these conditions, the harder it is to administer. Tax subsidies are not different from other subsidies in this respect.

For programs that fall into the easy-to-administer category, there are some advantages in using the IRS as a subsidy distribution mechanism. It is a well-run bureaucracy that deals annually with nearly 100 million taxpayers. It already has much of the information on income, family size, and other characteristics that may be used to determine eligibility, and it can make spot checks through its system of audits.

Only about 2 percent of returns are audited, however, and many subsidy programs have eligibility rules that rely on information that tax auditors rarely check. If, therefore, the Congress wants to keep fairly close watch on eligibility for a subsidy program, providing the subsidy through the tax system may not be the best approach. But if the Congress determines that the costs of detailed eligibility checks for a particular program are likely to be greater than the losses from payments to ineligible recipients, the tax system may be preferable to setting up a new or expanded bureaucracy to administer a direct spending subsidy.



A major drawback to using the IRS as a subsidy distribution agency is that it can impose a significant burden of extra complexity on both taxpayers and the IRS. With IRS resources already severely strained by frequent changes in tax legislation, expanding tax shelter activities, and apparently widespread tax evasion in the so-called "underground economy," the extra burden of running multiple subsidy programs could lead to administrative breakdowns.

Another consideration in having the IRS administer a subsidy program is that the IRS is not likely to be as sympathetic to the goals of the program as an agency with jurisdiction over analogous direct spending programs might be. When the IRS is assigned the task of administering subsidies for housing, employment, home insulation, preservation of historic buildings, local economic development, and the like, the usual response is to treat the subsidies as if they were normal tax provisions rather than subsidy programs. Eligibility is restricted as narrowly as possible, consistent with the provisions of the statute, in order to minimize the loss of revenue. Little attempt is made to publicize the availability of the subsidy or to promote its use. Attempts to overcome these problems by having tax subsidies jointly administered by the IRS and the agencies responsible for comparable spending programs are often bogged down by interagency conflicts over eligibility rules and administrative procedures.

#### Beneficiary Perceptions and Preferences

The beneficiaries of a tax subsidy usually prefer not to think of the tax savings they receive as a subsidy, but rather as something that results from a normal feature of the tax code. If there is likely to be substantial reluctance to take advantage of a subsidy--as seems to be the case with the present targeted jobs tax credit--having it work as much like a normal provision of the tax code as possible could encourage more widespread use.

Beneficiaries may also prefer receiving subsidies through the tax code because they may believe that the subsidies will be more stable and predictable than direct spending subsidies. While it is generally true that tax subsidies are less subject to changes, cutbacks, and delays in funding than federal spending programs, they are not immune from this kind of unpredictability. The legislative and administrative rules for various tax shelter and tax-exempt bond subsidies, for example, have been continually changed and tightened in recent years.

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## CHAPTER I. INTRODUCTION

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### DEFINITION

Tax expenditures are revenue losses that arise from provisions of the tax code that give special or selective tax relief to certain groups of taxpayers. They are defined in the Budget Act as:

. . . those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.<sup>1</sup>

There are certain features in an income tax that are an integral part of the normal structure of the tax, including general rate schedules and exemption levels, general rules on who is subject to tax and what accounting periods should be used, and deductions for the costs of earning taxable income. These normal features of an income tax are not considered tax expenditures. Only special provisions of the tax code that have some purpose beyond simply defining taxable net income fall into this category.

These special provisions are usually designed to encourage some desired activity or to provide aid to certain categories of taxpayers and are, thus, similar to many federal spending and loan programs. The investment tax credit, for example, is intended to encourage investment in business machinery and equipment, while the extra personal exemption for the blind gives special tax relief to these handicapped taxpayers.

There are sometimes difficulties in distinguishing between tax expenditures and provisions that are part of the normal structure of the tax code. The just-enacted deduction for two-earner married couples, for example, is treated as a tax expenditure. But if the Congress had adopted a broader approach and allowed married couples to be taxed separately at the lower rates applicable to single

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1. The Congressional Budget Act of 1974, Sec. 3(a)(3)).

persons, the change would probably have been regarded as a modification of the basic tax structure rather than as a tax expenditure. While there are always borderline definitional issues, there has been general Congressional and Executive branch agreement over the years on which provisions of the tax code are "special" enough to be termed tax expenditures.

#### VARIOUS INTERPRETATIONS

The identification of a provision of the tax code as a tax expenditure does not imply a judgment about the merits of the provision. Tax expenditures are simply one of the ways in which the federal government seeks to allocate resources or influence behavior in the private sector. Just as with federal spending or loan programs, evaluation of the provision depends on the purposes being served and the cost and effectiveness of the provision compared to other ways of promoting the same objective.

Nonetheless, listing the revenue losses from special-purpose provisions of the tax code in a "tax expenditure budget" has been viewed by many as a way of identifying "tax loopholes" that are ripe for abolition or reform. Many of the items in the tax expenditure budget are, in fact, cited frequently as potential revenue-raising tax reforms, but there are others that few would want to disturb and many want to expand.

Some have objected to the whole concept of tax expenditures on the ground that it implies that the federal government is entitled to 100 percent of everyone's income, and that any portion of it taxpayers are allowed to keep is theirs only by special sufferance. The base against which tax expenditures are measured is not all income, however; it is the amount of tax that would be collected by a normal tax system that allowed no special exceptions for nontax purposes. Tax expenditures are departures from the normal tax structure, which falls far short of taxing one hundred percent of all income.

It is frequently stated or implied in analyses of particular tax expenditures that a differently structured spending program would be better than the tax expenditure on equity, efficiency, or other grounds. The alternative to a tax expenditure need not be a spending program, however. The revenue gained from eliminating a tax expenditure might well be used to reduce the federal deficit or returned to taxpayers in the form of a more general tax cut.

Converting a tax expenditure into a more general tax cut is one way of reducing federal influence over the private sector. Instead of providing a tax saving only to those in special circumstances, or who arrange their affairs in special ways, tax savings could be extended more broadly, with no strings attached. This would give taxpayers greater freedom to decide for themselves how to use their money, with less attempt by the federal government to guide their decisions.

#### ALTERNATIVE TERMS

Tax expenditures are not exactly the same as direct expenditures in all respects. As the next chapter points out, measuring the cost of tax expenditures for budgetary purposes presents problems that do not arise for most spending programs. In addition, tax expenditures that involve a deferral of tax liability are more like loan programs than direct grant programs. There is also concern that the term "tax expenditure" has acquired an unduly negative connotation.

A variety of alternative terms has thus been suggested: tax incentive, tax advantage, tax benefit, tax concession, tax relief, tax subsidy, and so on. There is probably little to be gained by seeking a consensus on nomenclature. This report frequently uses the term "tax subsidy," but other synonyms may creep in from time to time.

#### OUTLINE OF THE REPORT

Chapter II describes some of the problems and issues involved in measuring tax expenditures and accounting for them in a way that is similar in budgetary terms to the treatment of spending programs. Chapter III analyzes some of the jurisdictional, budgetary, and administrative considerations in choosing among tax subsidies, direct expenditure subsidies, and general tax cuts. Chapter IV describes the new changes in tax expenditures enacted in 1980 and 1981, including those in the Economic Recovery Tax Act of 1981. The fiscal year 1982-1986 projections of tax expenditure revenue losses appears in Appendix A. These projections reflect the law in effect on January 1, 1981. Finally, there is an appendix listing tax expenditures under the committees that have jurisdiction over analogous direct expenditure programs.

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CHAPTER II. MEASUREMENT OF TAX EXPENDITURES

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Conceptually, tax expenditures are revenue the federal government does not collect, so measuring them presents some special practical problems. The amount of revenue the government has collected under existing law can be directly observed; so can the amount being spent. But the amount of revenue that would be collected under some different law must be estimated; it can never be directly observed. (The future effects of tax laws and spending programs must also be estimated, of course, but ultimately there are actual tax collections and outlays against which to test the estimates.) A tax system without tax expenditures is simply an abstraction; it exists in the mind, and can never be measured with the same precision that actual outlays and tax collections can.

Tax expenditure estimates are based on samples of tax returns from past years and other economic and demographic data. The specific techniques used to measure the different types of tax expenditures are as follows:

- o Tax Credits. The amount of the expenditure is equal to the amount of the credits claimed by taxpayers.
- o Preferential Rates. The expenditure is calculated by multiplying the amount of income to which the special rate is applied by the difference between the regular tax rate and the preferential tax rate.
- o Special Exclusions and Deductions. The expenditure is calculated by adding the amount excluded or deducted from taxable income back into the taxpayer's income, and then computing a new tax liability on that income; the tax expenditure is equal to the difference between the hypothetical tax liability so computed and the liability incurred under current law.<sup>1</sup>

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1. In some cases, removal of a particular provision would reduce the total of a person's itemized deductions beneath the stan-

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- o **Deferrals of Liability.** The expenditure is calculated as the difference between taxes paid under current law and those that would have been paid had the deferral never been allowed.

The revenue loss from each tax expenditure is estimated by comparing the revenue raised under current law with the revenue that would be raised if the provision had never existed, but both taxpayer behavior and all other tax provisions remained the same as they are under current law. This is not an estimate of the amount of revenue that would be gained if the provision were repealed, since repeal of the provision would likely change taxpayer behavior in ways that would generally reduce the revenue gain. It is also not an estimate of the revenue that would be gained if two or more tax expenditures were repealed simultaneously, since interactions among different tax expenditures and other tax provisions could make the revenue gain either more or less than if the tax expenditures were repealed separately.

Tax expenditures are similar in these respects to direct outlay programs in the federal budget. The outlay figures for a particular program do not represent the amount by which the deficit would be reduced if the program were eliminated, since elimination would usually lead to partly offsetting cost increases in other programs and reductions in tax receipts. Similarly, the budgetary saving from abolishing two spending programs simultaneously might not be the same as the sum of the saving from eliminating each separately.

In the case of both outlays and tax expenditures, the budgetary cost should be considered separately from the net effect on the federal deficit or surplus if the provision was eliminated. The net effect from elimination is almost always less than the direct cost, since all tax and spending changes have "reflow" or "feedback" effects that partially offset the direct effects of the change. Tax cuts, for example, may stimulate economic activity, which reduces some federal spending and increases tax collections, thereby offsetting some of the initial budgetary effects of the tax

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dard deduction or zero bracket amount, and the person would no longer itemize. In those cases, the tax expenditure is figured by taking the excess of his total itemized deductions over the zero bracket amount and multiplying that excess by the appropriate marginal rate.

cut. Spending cuts may reduce economic activity, leading to partially offsetting federal spending increases and reductions in tax collections.

Because the estimates of individual tax expenditures are generally consistent methodologically with those of individual spending programs, subsidies of both kinds can readily be compared. A further refinement, discussed below under "outlay equivalents," would make this comparison even more precise. The tax expenditure budget thus highlights some of the possible choices and trade-offs in allocating scarce resources. By accounting for the federal resources devoted to specific purposes through the tax code, it permits consideration of alternative uses of those resources for other purposes, or for the same purposes through a different mechanism. In 1981, for example, the Congress had a number of options for dealing with the \$200/400 interest and dividend exclusion. The provision could have been continued at its existing level, or the \$3 billion in revenue that it cost each year could have been used to finance a 1 percentage point across-the-board reduction in tax rates, an expansion of Individual Retirement Accounts (IRAs) and Keogh plans, direct federal assistance for the savings and loan industry, a reduction in the federal deficit, or increases in other spending programs. In the end, the Congress decided to eliminate the interest exclusion after 1981, and use the savings to fund a temporary new program of one-year \$1,000 tax-exempt savings certificates, to be followed in 1985 by a new 15 percent net interest exclusion for the first \$3000 of net interest.

#### LIMITATIONS OF TAX EXPENDITURE ESTIMATES

##### Arithmetic Totals

While the estimates of individual tax expenditures permit useful comparisons with the outlays for similar programs, the arithmetic total of all the tax expenditure estimates has significant limitations. As was noted earlier, the cost of each tax expenditure is estimated by determining how much additional revenue would be collected if the provision did not exist. This presents some special problems when more than one tax expenditure is involved. If three or four tax expenditures that take the form of personal deductions did not exist, for example, more people would use the standard deduction (zero bracket amount), and the net cost would be less than if each deduction was considered separately. The standard deduction would absorb part of the cost that would

otherwise be assigned to the tax expenditures. On the other hand, if three or four tax expenditures that took the form of exclusions from income no longer existed, more income would be taxed at higher marginal tax rates, so that the cost would be more than if each exclusion were considered separately.

It is difficult to say which of these effects predominates in the tax expenditure budget as a whole. It is possible to deal with the problem by calculating the total amount of revenue that would be collected under an ideal or "normal" tax system with no tax expenditures, and subtracting from that the amount that is collected under the present tax system. The difference would represent the total revenue loss from all tax expenditures with all interactions taken into account. Such calculations have been made, but they require a large number of assumptions about the components of the alternative tax system and the economic conditions that would accompany it.<sup>2</sup> Using different assumptions would produce very different results.

In addition, the revenue loss estimates for the various tax expenditures would vary widely, depending on the other components of the system and the order in which each tax expenditure was entered into the estimating model. The resulting uncertainty and variation in the individual tax expenditure estimates could significantly lessen their usefulness for program analysis purposes. Since the main purpose of the tax expenditure budget is to make it possible to compare the costs of individual tax expenditures with alternative uses of the same resources, only limited efforts have been made to prepare internally consistent estimates of the totals.<sup>3</sup>

2. For an example, see Joseph A. Pechman, ed., Comprehensive Income Taxation (The Brookings Institution, 1977), pp. 277-298. Revenues under the comprehensive income tax outlined in the Pechman book range from 43.5 percent to 71.5 percent above then-current law, depending on the level of personal deductions allowed.
3. For some examples, see Budget of the U.S. Government, Fiscal Year 1982, Special Analyses, pp. 212 and 218 (showing the revenue losses from all tax expenditures that take the form of itemized deductions to be \$62.3 billion in fiscal year 1982,

(Continued)

Year-To-Year Comparisons. Despite the limitations of the arithmetic totals, it can be useful to look at the pattern of growth in the totals over time, since the revenue loss estimates have been made in roughly the same way each year. As is shown in Table 1, the number of the items in the tax expenditure budget has grown from 50 in calendar year 1967, the first year for which the budget was compiled, to 104 in fiscal year 1982. The arithmetic total of the revenue loss estimates has grown from \$36.6 billion in 1967 to \$266.3 billion in 1982.

To some extent, as indicated in Table 2, the growth in the number of items is the result of definitional changes: some items not previously considered tax expenditures were added to the list, and some items have been subdivided. Part of the growth in the revenue loss totals occurred because more income has been taxed at higher marginal tax rates in recent years because of inflation-induced "bracket creep" in the individual income tax and real growth in incomes. Since the revenue loss from special deductions and exclusions is measured by multiplying the amount of the deduction or exclusion by the tax rate, higher losses result when income is taxed at higher rates. Nonetheless, a significant share of the growth in both the number of items and the revenue loss totals is due to the addition of new tax expenditures by legislative action. Table 2 shows the number of tax expenditures added and eliminated by legislative action for each year from 1967 to 1986.

While general, order-of-magnitude comparisons of the arithmetic totals over time can be useful, the comparisons should not be carried too far. The estimates done in different years generally use different economic, demographic, and other assumptions. And unlike budget outlay and revenue estimates, the estimates never become actuals. In addition, as better information on specific provisions becomes available and as estimating techniques are improved, significant changes may be made in the estimates from one year to the next. The fiscal year 1981 revenue loss from tax-exempt industrial development bonds, for example, was estimated at \$695 million in 1979. By 1981, however, new information on previously unreported bond issues led to a new revenue loss estimate for fiscal year 1981 of \$1.23 billion. The estimates made in

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compared to an arithmetic total of the separate items of \$81.8 billion, and the loss from the home mortgage interest and property tax deductions to be \$35.5 billion together and \$36.2 billion when calculated separately).

TABLE 1. TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION, CALENDAR YEARS 1967-1973 AND FISCAL YEARS 1974-1986 (in millions of dollars)<sup>a</sup>

| Function and Subfunction                                                  | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975  | 1976  |
|---------------------------------------------------------------------------|------|------|------|------|------|------|------|------|-------|-------|
| 050 NATIONAL DEFENSE                                                      |      |      |      |      |      |      |      |      |       |       |
| 051 Department of Defense - Military                                      |      |      |      |      |      |      |      |      |       |       |
| Exclusion of benefits and allowances to Armed Forces personnel            | 500  | 550  | 550  | 500  | 650  | 700  | 700  | 650  | 650   | 650   |
| Exclusion of military disability pensions                                 | --   | --   | --   | --   | --   | --   | --   | 65   | 70    | 80    |
| 150 INTERNATIONAL AFFAIRS                                                 |      |      |      |      |      |      |      |      |       |       |
| 155 International Finance Programs                                        |      |      |      |      |      |      |      |      |       |       |
| Exclusion of income earned abroad by U.S. citizens                        | 40   | 45   | 45   | 40   | 50   | 50   | 50   | 90   | 130   | 145   |
| Deferral of income of domestic international sales corporations (DISC)    | --   | --   | --   | --   | --   | 100  | 170  | 870  | 1,130 | 1,340 |
| Deferral of income of controlled foreign corporations                     | 150  | 165  | 170  | 165  | 165  | 325  | 350  | 620  | 590   | 525   |
| Exclusion of gross-up on dividends of less developed country corporations | 50   | 55   | 55   | 55   | 55   | 60   | 70   | 55   | 55    | 55    |
| Special rate for Western Hemisphere Trade Corporations                    | 50   | 55   | 55   | 50   | 75   | 50   | 75   | 50   | 50    | 50    |

(Continued)



TABLE 1. (Continued)

| Function and Subfunction           | 1977  | 1978  | 1979  | 1980  | 1981  | 1982  | 1983  | 1984  | 1985  | 1986  |
|------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 050 NATIONAL DEFENSE               |       |       |       |       |       |       |       |       |       |       |
| 051 Department of Defense -        |       |       |       |       |       |       |       |       |       |       |
| Military                           |       |       |       |       |       |       |       |       |       |       |
| Exclusion of benefits and          |       |       |       |       |       |       |       |       |       |       |
| allowances to Armed Forces         | 1,095 | 1,260 | 1,370 | 1,470 | 1,585 | 1,715 | 1,850 | 2,000 | 2,160 | 2,335 |
| personnel                          |       |       |       |       |       |       |       |       |       |       |
| Exclusion of military              |       |       |       |       |       |       |       |       |       |       |
| disability pensions                | 105   | 115   | 120   | 125   | 170   | 200   | 245   | 285   | 325   | 370   |
| 150 INTERNATIONAL AFFAIRS          |       |       |       |       |       |       |       |       |       |       |
| 155 International Finance Programs |       |       |       |       |       |       |       |       |       |       |
| Exclusion of income earned         |       |       |       |       |       |       |       |       |       |       |
| abroad by U.S. citizens            | 120   | 360   | 530   | 555   | 640   | 665   | 720   | 775   | 840   | 905   |
| Deferral of income of domes-       |       |       |       |       |       |       |       |       |       |       |
| tic international sales            |       |       |       |       |       |       |       |       |       |       |
| corporations (DISC)                | 1,030 | 1,135 | 1,170 | 1,400 | 1,600 | 1,630 | 1,730 | 1,810 | 1,870 | 1,930 |
| Deferral of income of con-         |       |       |       |       |       |       |       |       |       |       |
| trolled foreign                    |       |       |       |       |       |       |       |       |       |       |
| corporations                       | 410   | 615   | 530   | 445   | 480   | 520   | 560   | 605   | 650   | 705   |
| Exclusion of gross-up on           |       |       |       |       |       |       |       |       |       |       |
| dividends of less developed        |       |       |       |       |       |       |       |       |       |       |
| country corporations               | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Special rate for Western           |       |       |       |       |       |       |       |       |       |       |
| Hemisphere Trade                   |       |       |       |       |       |       |       |       |       |       |
| Corporations                       | 35    | 25    | 15    | 5     | ---   | ---   | ---   | ---   | ---   | ---   |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                                                     | 1967  | 1968  | 1969  | 1970 | 1971 | 1972  | 1973  | 1974  | 1975  | 1976  |
|------------------------------------------------------------------------------------------------------------------------------|-------|-------|-------|------|------|-------|-------|-------|-------|-------|
| 250 GENERAL SCIENCE, SPACE,<br>AND TECHNOLOGY                                                                                |       |       |       |      |      |       |       |       |       |       |
| 251 General Science and Basic<br>Research                                                                                    |       |       |       |      |      |       |       |       |       |       |
| Expensing of research and<br>development expenditures                                                                        | 500   | 550   | 565   | 540  | 545  | 570   | 580   | 605   | 635   | 660   |
| 270 ENERGY                                                                                                                   |       |       |       |      |      |       |       |       |       |       |
| 271 Energy Supply                                                                                                            |       |       |       |      |      |       |       |       |       |       |
| Expensing of exploration and<br>development costs                                                                            |       |       |       |      |      |       |       |       |       |       |
| Oil and gas                                                                                                                  | 300   | 330   | 340   | 325  | 325  | 650   | 750   | 830   | 620   | 805   |
| Other fuels                                                                                                                  | ---   | ---   | ---   | ---  | ---  | ---   | ---   | ---   | ---   | ---   |
| Excess of percentage over<br>cost depletion                                                                                  |       |       |       |      |      |       |       |       |       |       |
| Oil and gas                                                                                                                  | 1,300 | 1,430 | 1,470 | 980  | 985  | 1,700 | 1,900 | 2,120 | 2,475 | 1,580 |
| Other fuels                                                                                                                  | ---   | ---   | ---   | ---  | ---  | ---   | ---   | ---   | ---   | ---   |
| Capital gains treatment of<br>royalties on coal                                                                              | 5     | 5     | 5     | 5    | 5    | 5     | 5     | 5     | 50    | 60    |
| Alternative fuel production<br>credit                                                                                        | ---   | ---   | ---   | ---  | ---  | ---   | ---   | ---   | ---   | ---   |
| Alcohol fuel credit                                                                                                          | ---   | ---   | ---   | ---  | ---  | ---   | ---   | ---   | ---   | ---   |
| Exclusion of interest on state<br>and local government indus-<br>trial development bonds for<br>energy production facilities | ---   | ---   | ---   | ---  | ---  | ---   | ---   | ---   | ---   | ---   |
| Residential energy credits                                                                                                   | ---   | ---   | ---   | ---  | ---  | ---   | ---   | ---   | ---   | ---   |
| Supply incentives                                                                                                            | ---   | ---   | ---   | ---  | ---  | ---   | ---   | ---   | ---   | ---   |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                                                          | 1977  | 1978  | 1979  | 1980  | 1981  | 1982  | 1983  | 1984  | 1985  | 1986  |
|-----------------------------------------------------------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 250 GENERAL SCIENCE, SPACE,<br>AND TECHNOLOGY                                                                                     |       |       |       |       |       |       |       |       |       |       |
| 251 General Science and Basic<br>Research                                                                                         |       |       |       |       |       |       |       |       |       |       |
| Expensing of research and<br>development expenditures                                                                             | 1,425 | 1,480 | 1,580 | 1,795 | 2,030 | 2,280 | 2,550 | 2,845 | 3,170 | 3,525 |
| 270 ENERGY                                                                                                                        |       |       |       |       |       |       |       |       |       |       |
| 271 Energy Supply                                                                                                                 |       |       |       |       |       |       |       |       |       |       |
| Expensing of exploration<br>and development costs                                                                                 |       |       |       |       |       |       |       |       |       |       |
| Oil and gas                                                                                                                       | 715   | 1,185 | 1,490 | 2,190 | 2,735 | 2,945 | 3,460 | 4,075 | 4,635 | 5,120 |
| Other fuels                                                                                                                       | ---   | ---   | ---   | ---   | 25    | 25    | 30    | 30    | 35    | 35    |
| Excess of percentage over<br>cost depletion                                                                                       |       |       |       |       |       |       |       |       |       |       |
| Oil and gas                                                                                                                       | 1,310 | 1,460 | 1,625 | 2,130 | 2,125 | 2,260 | 2,270 | 2,285 | 2,755 | 3,260 |
| Other fuels                                                                                                                       | ---   | ---   | ---   | ---   | 550   | 565   | 630   | 695   | 765   | 840   |
| Capital gains treatment<br>of royalties on coal                                                                                   | 65    | 65    | 75    | 85    | 90    | 100   | 120   | 135   | 150   | 170   |
| Alternative fuel production<br>credit                                                                                             | ---   | ---   | ---   | ---   | 25    | 55    | 50    | 20    | 10    | ---   |
| Alcohol fuel credit                                                                                                               | ---   | ---   | ---   | ---   | b     | 15    | 25    | 40    | 65    | 85    |
| Exclusion of interest on<br>state and local govern-<br>ment industrial develop-<br>ment bonds for energy<br>production facilities | ---   | ---   | ---   | ---   | b     | 5     | 15    | 20    | 30    | 30    |
| Residential energy credits                                                                                                        | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Supply incentives                                                                                                                 | ---   | ---   | 715   | 460   | 115   | 190   | 275   | 360   | 520   | 650   |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                                                                                                                                             | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|------|------|------|------|------|------|------|------|------|
| 271 <u>Energy Supply (continued)</u><br>Alternative conservation<br>and new technology credits<br>Supply incentives                                                                                                  | --   | --   | --   | --   | --   | --   | --   | --   | --   | --   |
| 272 <u>Energy Conservation</u><br>Residential energy credits<br>Conservation incentives<br>Alternative conservation and<br>new technology credits<br>Conservation incentives<br>Energy credit for intercity<br>buses | --   | --   | --   | --   | --   | --   | --   | --   | --   | --   |
| 300 <u>NATURAL RESOURCES AND ENVIRONMENT</u>                                                                                                                                                                         |      |      |      |      |      |      |      |      |      |      |
| 302 <u>Conservation and Land Management</u><br>Capital gains treatment of<br>certain timber income<br>Investment credit and seven-<br>year amortization for<br>reforestation expenditures                            | 130  | 140  | 140  | 130  | 175  | 175  | 240  | 185  | 205  | 215  |
| 303 <u>Recreational Resources</u><br>Tax incentives for preserva-<br>tion of historic structures                                                                                                                     | --   | --   | --   | --   | --   | --   | --   | --   | --   | --   |
| 304 <u>Pollution Control and Abatement</u><br>Exclusion of interest on state<br>and local government pollu-<br>tion control bonds                                                                                    | --   | --   | --   | --   | --   | --   | --   | --   | 110  | 160  |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                     | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985  | 1986  |
|------------------------------------------------------------------------------|------|------|------|------|------|------|------|------|-------|-------|
| 271 <u>Energy Supply (continued)</u>                                         |      |      |      |      |      |      |      |      |       |       |
| Alternative conservation and new technology credits                          | ---  | ---  | 220  | 390  | 225  | 315  | 645  | 980  | 1,055 | 820   |
| Supply incentives                                                            | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---   |
| 272 <u>Energy Conservation</u>                                               |      |      |      |      |      |      |      |      |       |       |
| Residential energy credits                                                   | ---  | ---  | ---  | ---  | 425  | 420  | 420  | 435  | 445   | 385   |
| Conservation incentives                                                      | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---   |
| Alternative conservation and new technology credits                          | ---  | ---  | ---  | ---  | 295  | 375  | 320  | 175  | 80    | 25    |
| Conservation incentives                                                      | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---   |
| Energy credit for intercity buses                                            | ---  | ---  | ---  | ---  | 5    | 5    | 5    | 5    | 5     | 5     |
| 300 <u>NATURAL RESOURCES AND ENVIRONMENT</u>                                 |      |      |      |      |      |      |      |      |       |       |
| 302 <u>Conservation and Land Management</u>                                  |      |      |      |      |      |      |      |      |       |       |
| Capital gains treatment of certain timber income                             | 395  | 265  | 405  | 540  | 605  | 685  | 670  | 865  | 975   | 1,095 |
| Investment credit and seven-year amortization for reforestation expenditures | ---  | ---  | ---  | ---  | 5    | 5    | 5    | 10   | 10    | 10    |
| 303 <u>Recreational Resources</u>                                            |      |      |      |      |      |      |      |      |       |       |
| Tax incentives for preservation of historic structures                       | b    | b    | 10   | 35   | 65   | 100  | 140  | 170  | 160   | 125   |
| 304 <u>Pollution Control and Abatement</u>                                   |      |      |      |      |      |      |      |      |       |       |
| Exclusion of interest on state and local government pollution control bonds  | 245  | 330  | 415  | 460  | 720  | 755  | 815  | 860  | 895   | 915   |

(Continued)



TABLE 1. (Continued)

| Function and Subfunction                                                                  | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 | 1973  | 1974 | 1975 | 1976 |
|-------------------------------------------------------------------------------------------|------|------|------|------|------|------|-------|------|------|------|
| <b>304 Pollution Control and Abatement</b>                                                |      |      |      |      |      |      |       |      |      |      |
| (continued)                                                                               |      |      |      |      |      |      |       |      |      |      |
| Five-year amortization on pollution control facilities                                    | ---  | ---  | 15   | 15   | 15   | 25   | 35    | 35   | 30   | 20   |
| Exclusion of payments in aid of construction of water, sewage, gas and electric utilities | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---  | ---  | ---  |
| <b>306 Other Natural Resources</b>                                                        |      |      |      |      |      |      |       |      |      |      |
| Expensing of exploration and development costs, nonfuel minerals                          | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---  | ---  | ---  |
| Excess of percentage over cost depletion, nonfuel materials                               | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---  | ---  | ---  |
| Capital gains treatment of iron ore                                                       | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---  | ---  | ---  |
| <b>350 AGRICULTURE</b>                                                                    |      |      |      |      |      |      |       |      |      |      |
| <b>351 Farm Income Stabilization</b>                                                      |      |      |      |      |      |      |       |      |      |      |
| Expensing of certain capital outlays                                                      | 800  | 860  | 880  | 820  | 840  | 900  | 1,100 | 750  | 610  | 460  |
| Capital gains treatment of certain ordinary income                                        | ---  | ---  | ---  | ---  | ---  | ---  | ---   | 550  | 485  | 520  |
| Deductibility of patronage dividends and certain other items of cooperatives              | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---  | 395  | 410  |
| Exclusion of certain cost-sharing payments                                                | ---  | ---  | ---  | ---  | ---  | ---  | ---   | ---  | ---  | ---  |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                           | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986        |
|----------------------------------------------------------------------------------------------------|------|------|------|------|------|------|------|------|------|-------------|
| 304 Pollution Control and Abatement<br>(continued)                                                 |      |      |      |      |      |      |      |      |      |             |
| Five-year amortization on<br>pollution control<br>facilities                                       | -80  | -130 | -25  | -10  | 35   | 65   | 95   | 110  | 115  | 115         |
| Exclusion of payments in<br>aid of construction of<br>water, sewage, gas and<br>electric utilities | 15   | 10   | 10   | 60   | 110  | 115  | 115  | 120  | 125  | 130         |
| 306 Other Natural Resources                                                                        |      |      |      |      |      |      |      |      |      |             |
| Expensing of exploration<br>and development costs,<br>nonfuel minerals                             | ---  | ---  | ---  | ---  | 25   | 25   | 30   | 30   | 35   | 35          |
| Excess of percentage over<br>cost depletion, nonfuel<br>materials                                  | ---  | ---  | ---  | ---  | 405  | 395  | 435  | 470  | 500  | 610         |
| Capital gains treatment of<br>iron ore                                                             | ---  | 10   | 20   | 20   | 20   | 20   | 20   | 20   | 20   | 20          |
| 350 AGRICULTURE                                                                                    |      |      |      |      |      |      |      |      |      |             |
| 351 Farm Income Stabilization                                                                      |      |      |      |      |      |      |      |      |      |             |
| Expensing of certain capital<br>outlays                                                            | 450  | 515  | 520  | 505  | 530  | 565  | 590  | 610  | 635  | 655         |
| Capital gains treatment of<br>certain ordinary income                                              | 340  | 360  | 375  | 405  | 430  | 450  | 470  | 500  | 520  | 550         |
| Deductibility of patronage<br>dividends and certain other<br>items of cooperatives                 | 290  | 315  | 335  | 365  | 400  | 430  | 460  | 480  | 520  | 565         |
| Exclusion of certain cost-<br>sharing payments                                                     | ---  | ---  | b    | 30   | 75   | 80   | 80   | 75   | 80   | 80          |
| -----                                                                                              |      |      |      |      |      |      |      |      |      |             |
|                                                                                                    |      |      |      |      |      |      |      |      |      | (Continued) |

TABLE 1. (Continued)

| Function and Subfunction                                                          | 1967  | 1968  | 1969  | 1970  | 1971  | 1972  | 1973  | 1974  | 1975  | 1976  |
|-----------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 370 COMMERCE AND HOUSING CREDIT                                                   |       |       |       |       |       |       |       |       |       |       |
| 371 Mortgage Credit and Thrift Insurance                                          |       |       |       |       |       |       |       |       |       |       |
| Excess bad debt reserves of financial institutions                                | 600   | 660   | 680   | 380   | 400   | 400   | 380   | 1,000 | 880   | 815   |
| Deductibility of mortgage interest on owner-occupied homes                        | 1,900 | 2,200 | 2,600 | 2,800 | 2,400 | 3,500 | 4,000 | 4,870 | 5,405 | 4,545 |
| Deductibility of property tax on owner-occupied homes                             | 1,800 | 2,350 | 2,800 | 2,900 | 2,700 | 3,250 | 3,500 | 4,060 | 4,510 | 3,690 |
| Exclusion of interest on state and local housing bonds for owner-occupied housing | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Deferral of capital gains on homes sales                                          | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 255   | 805   | 845   |
| Exclusion of capital gains on home sales for persons age 55 and over              | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 10    | 40    | 45    |
| Credit for purchase of new homes                                                  | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 625   |
| 376 Other Advancement and Regulation of Commerce                                  |       |       |       |       |       |       |       |       |       |       |
| Dividend and interest exclusion                                                   | 225   | 260   | 290   | 280   | 300   | 300   | 325   | 320   | 315   | 335   |
| Exclusion of interest on state and local industrial development bonds             | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 175   | 225   |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                          | 1977  | 1978  | 1979  | 1980   | 1981   | 1982   | 1983   | 1984   | 1985   | 1986   |
|-----------------------------------------------------------------------------------|-------|-------|-------|--------|--------|--------|--------|--------|--------|--------|
| 370 COMMERCE AND HOUSING CREDIT                                                   |       |       |       |        |        |        |        |        |        |        |
| 371 Mortgage Credit and Thrift Insurance                                          |       |       |       |        |        |        |        |        |        |        |
| Excess bad debt reserves of financial institutions                                | 560   | 705   | 780   | 855    | 340    | 470    | 525    | 620    | 750    | 895    |
| Deductibility of mortgage interest on owner-occupied homes                        | 5,435 | 4,985 | 8,225 | 12,505 | 19,805 | 25,295 | 31,115 | 37,960 | 46,310 | 56,500 |
| Deductibility of property tax on owner-occupied homes                             | 4,500 | 4,665 | 5,920 | 7,740  | 8,915  | 10,705 | 12,740 | 15,160 | 18,040 | 21,465 |
| Exclusion of interest on state and local housing bonds for owner-occupied housing | ---   | ---   | 540   | 665    | 840    | 1,220  | 1,600  | 1,855  | 1,890  | 1,810  |
| Deferral of capital gains on home sales                                           | 890   | 935   | 1,125 | 1,010  | 1,100  | 1,220  | 1,345  | 1,480  | 1,630  | 1,790  |
| Exclusion of capital gains on home sales for persons age 55 and over              | 40    | 70    | 300   | 535    | 590    | 650    | 710    | 785    | 860    | 950    |
| Credit for purchase of new homes                                                  | 100   | ---   | ---   | ---    | ---    | ---    | ---    | ---    | ---    | ---    |
| 376 Other Advancement and Regulation of Commerce                                  |       |       |       |        |        |        |        |        |        |        |
| Dividend and interest exclusion                                                   | 410   | 475   | 450   | 490    | 1,325  | 3,170  | 2,340  | 700    | 770    | 850    |
| Exclusion of interest on state and local industrial development bonds             | 285   | 350   | 495   | 745    | 1,230  | 1,550  | 1,980  | 2,410  | 2,855  | 3,310  |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                           | 1967  | 1968  | 1969  | 1970  | 1971  | 1972  | 1973  | 1974  | 1975  | 1976  |
|------------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 376 Other Advancement and Regulation of Commerce (continued)                       |       |       |       |       |       |       |       |       |       |       |
| Exemption of credit union income                                                   | 40    | 45    | 45    | 40    | 40    | 90    | 100   | 105   | 115   | 125   |
| Exclusion of interest on life insurance savings                                    | 900   | 1,000 | 1,050 | 1,050 | 1,100 | 1,200 | 1,300 | 1,420 | 1,545 | 1,695 |
| Deductibility of interest on consumer credit                                       | 1,300 | 1,600 | 1,700 | 1,700 | 1,800 | 1,100 | 1,250 | 2,435 | 1,185 | 1,040 |
| Expensing of construction period interest and taxes                                | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 1,510 | 1,565 |
| Excess first-year depreciation                                                     | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 275   | 225   |
| Depreciation on rental housing in excess of straight line                          | 250   | 250   | 275   | 255   | 500   | 600   | 600   | 480   | 520   | 550   |
| Depreciation on buildings (other than rental housing)                              | 500   | 550   | 550   | 500   | 480   | 500   | 530   | 505   | 440   | 490   |
| in excess of straight line                                                         | ---   | ---   | ---   | ---   | 700   | 860   | 1,250 | 1,260 | 1,405 | 1,590 |
| Asset depreciation range                                                           | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Amortization of business start-up costs                                            | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Capital gains other than agriculture, timber, iron ore, and coal                   | 500   | 525   | 525   | 425   | 5,980 | 7,400 | 5,880 | 6,895 | 5,785 | 6,215 |
| Capital gains at death                                                             | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 5,000 | 6,450 | 6,720 |
| Corporate surtax exemption                                                         | 1,800 | 2,000 | 2,300 | 2,000 | 2,300 | 2,500 | 3,100 | 3,270 | 3,345 | 5,020 |
| Reduced rates on the first \$100,000 of corporate income                           | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Investment credit, other than for ESOP's, rehabilitation of structures, and energy | 2,300 | 3,000 | 2,630 | 910   | 1,800 | 3,800 | 4,300 | 4,570 | 5,810 | 8,260 |

(Continued)



TABLE 1. (Continued)

| Function and Subfunction                                                           | 1977   | 1978   | 1979   | 1980   | 1981   | 1982   | 1983   | 1984   | 1985   | 1986   |
|------------------------------------------------------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| 376 Other Advancement and Regulation of Commerce (continued)                       |        |        |        |        |        |        |        |        |        |        |
| Exemption of credit union income                                                   | 165    | 80     | 90     | 110    | 115    | 125    | 140    | 155    | 170    | 190    |
| Exclusion of interest on life insurance savings                                    | 1,815  | 2,025  | 2,475  | 3,365  | 4,080  | 4,770  | 5,570  | 6,500  | 7,585  | 8,845  |
| Deductibility of interest on consumer credit                                       | 2,310  | 2,120  | 2,585  | 3,595  | 5,260  | 6,040  | 7,050  | 7,965  | 9,005  | 10,175 |
| Expensing of construction period interest and taxes                                | 625    | 640    | 615    | 695    | 760    | 875    | 915    | 990    | 1,065  | 1,140  |
| Excess first-year depreciation                                                     | 180    | 190    | 185    | 185    | 195    | 205    | 215    | 230    | 245    | 250    |
| Depreciation on rental housing in excess of straight line                          | 505    | 370    | 360    | 350    | 400    | 425    | 455    | 495    | 535    | 580    |
| Depreciation on buildings (other than rental housing)                              |        |        |        |        |        |        |        |        |        |        |
| in excess of straight line                                                         | 395    | 265    | 255    | 255    | 265    | 285    | 315    | 350    | 395    | 450    |
| Asset depreciation range                                                           | 1,805  | 2,360  | 2,590  | 3,030  | 3,765  | 4,110  | 4,555  | 4,510  | 4,200  | 4,035  |
| Amortization of business start-up costs                                            | ---    | ---    | ---    | ---    | 20     | 75     | 115    | 180    | 255    | 315    |
| Capital gains other than agriculture, timber, iron ore, and coal                   |        |        |        |        |        |        |        |        |        |        |
| Capital gains at death                                                             | 7,585  | 7,970  | 8,075  | 14,570 | 17,170 | 20,010 | 22,220 | 24,655 | 27,360 | 30,350 |
| Corporate surtax exemption                                                         | 7,280  | 8,120  | 9,015  | 4,750  | 5,085  | 5,440  | 5,820  | 6,225  | 6,660  | 7,130  |
| Reduced rates on the first \$100,000 of corporate income                           | 4,650  | 3,885  | 3,070  | 115    | ---    | ---    | ---    | ---    | ---    | ---    |
| Investment credit, other than for ESOP's, rehabilitation of structures, and energy | ---    | ---    | 3,270  | 7,555  | 7,395  | 7,590  | 8,495  | 9,485  | 10,520 | 11,650 |
|                                                                                    | 10,610 | 13,125 | 16,070 | 18,615 | 19,525 | 20,765 | 23,080 | 25,445 | 28,000 | 30,915 |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                    | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 |
|-------------------------------------------------------------|------|------|------|------|------|------|------|------|------|------|
| 400 TRANSPORTATION                                          |      |      |      |      |      |      |      |      |      |      |
| 401 Ground Transportation                                   |      |      |      |      |      |      |      |      |      |      |
| Five-year amortization on railroad rolling stock            | ---  | ---  | ---  | 105  | 45   | 80   | 40   | 70   | 55   | 30   |
| Deductibility of nonbusiness state gasoline taxes           | ---  | ---  | ---  | ---  | ---  | ---  | ---  | 865  | 820  | 575  |
| 403 Water Transportation                                    |      |      |      |      |      |      |      |      |      |      |
| Deferral of tax on shipping companies                       | 10   | 10   | 10   | 10   | 10   | 30   | 40   | 35   | 70   | 105  |
| 450 COMMUNITY AND REGIONAL DEVELOPMENT                      |      |      |      |      |      |      |      |      |      |      |
| 451 Community Development                                   |      |      |      |      |      |      |      |      |      |      |
| Five-year amortization for rehabilitation of housing        | ---  | ---  | ---  | ---  | 25   | 40   | 50   | 85   | 105  | 90   |
| Investment credit for rehabilitation of structures          | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  |
| 500 EDUCATION, TRAINING, EMPLOYMENT AND SOCIAL SERVICES     |      |      |      |      |      |      |      |      |      |      |
| 502 Higher Education                                        |      |      |      |      |      |      |      |      |      |      |
| Exclusion of scholarship and fellowship income              | 50   | 60   | 60   | 60   | 110  | 125  | 140  | 195  | 200  | 210  |
| Employer educational assistance                             | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  |
| Exclusion of interest on state and local student loan bonds | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                    | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|-------------------------------------------------------------|------|------|------|------|------|------|------|------|------|------|
| 400 TRANSPORTATION                                          |      |      |      |      |      |      |      |      |      |      |
| 401 <u>Ground Transportation</u>                            |      |      |      |      |      |      |      |      |      |      |
| Five-year amortization on railroad rolling stock            | -35  | -40  | -40  | -40  | -40  | -40  | -35  | -20  | ---  | ---  |
| Deductibility of nonbusiness state gasoline taxes           | 795  | 760  | 350  | ---  | ---  | ---  | ---  | ---  | ---  | ---  |
| 403 <u>Water Transportation</u>                             |      |      |      |      |      |      |      |      |      |      |
| Deferral of tax on shipping companies                       | 90   | 105  | 75   | 70   | 75   | 75   | 80   | 90   | 95   | 105  |
| 450 COMMUNITY AND REGIONAL DEVELOPMENT                      |      |      |      |      |      |      |      |      |      |      |
| 451 <u>Community Development</u>                            |      |      |      |      |      |      |      |      |      |      |
| Five-year amortization for rehabilitation of housing        | 30   | 15   | 15   | 15   | 25   | 35   | 35   | 35   | 25   | 10   |
| Investment credit for rehabilitation of structures          | ---  | ---  | 65   | 180  | 295  | 335  | 385  | 425  | 460  | 495  |
| 500 EDUCATION, TRAINING, EMPLOYMENT AND SOCIAL SERVICES     |      |      |      |      |      |      |      |      |      |      |
| 502 <u>Higher Education</u>                                 |      |      |      |      |      |      |      |      |      |      |
| Exclusion of scholarship and fellowship income              | 250  | 295  | 355  | 375  | 410  | 490  | 565  | 655  | 765  | 885  |
| Employer educational assistance                             | ---  | ---  | 20   | 30   | 35   | 40   | 45   | 25   | ---  | ---  |
| Exclusion of interest on state and local student loan bonds | ---  | ---  | ---  | ---  | 80   | 125  | 170  | 215  | 260  | 300  |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                                          | 1967  | 1968  | 1969  | 1970  | 1971  | 1972  | 1973  | 1974  | 1975  | 1976  |
|-------------------------------------------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>502 Higher Education (continued)</b>                                                                           |       |       |       |       |       |       |       |       |       |       |
| Parental personal exemption for students, age 19 or over                                                          | 500   | 500   | 525   | 500   | 550   | 640   | 675   | 655   | 670   | 690   |
| Deductibility of charitable contributions (education)                                                             | 170   | 200   | 200   | 200   | 275   | 275   | 300   | 510   | 645   | 665   |
| <b>504 Training and Employment</b>                                                                                |       |       |       |       |       |       |       |       |       |       |
| Maximum tax on personal service income                                                                            | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 330   | 400   | 480   |
| Credit for child and dependent care expenses                                                                      | 25    | 25    | 25    | 25    | 30    | 180   | 180   | 230   | 295   | 330   |
| Deduction/credit for employment of AFDC recipients and public assistance recipients under work incentive programs | ---   | ---   | ---   | ---   | ---   | 5     | 5     | 5     | 10    | 10    |
| General jobs credit                                                                                               | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Targeted jobs credit                                                                                              | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Five-year amortization of child care facilities                                                                   | ---   | ---   | ---   | ---   | ---   | 5     | 5     | 5     | 5     | 5     |
| <b>505 Other Labor Services</b>                                                                                   |       |       |       |       |       |       |       |       |       |       |
| Exclusion of employee meals and lodging (other than military)                                                     | 150   | 165   | 170   | 170   | 170   | 170   | 170   | 175   | 265   | 285   |
| Investment credit for ESOP's                                                                                      | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| <b>506 Social Services</b>                                                                                        |       |       |       |       |       |       |       |       |       |       |
| Deductibility of charitable contributions, other than education and health                                        | 2,200 | 3,000 | 3,450 | 3,550 | 3,200 | 3,100 | 3,400 | 4,110 | 3,725 | 3,285 |
| Exclusion of contributions to prepaid legal services plans                                                        | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                                          | 1977  | 1978  | 1979  | 1980  | 1981  | 1982  | 1983   | 1984   | 1985   | 1986   |
|-------------------------------------------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|--------|--------|--------|--------|
| 502 Higher Education (continued)                                                                                  |       |       |       |       |       |       |        |        |        |        |
| Parental personal exemption for students age 19 or over                                                           | 750   | 770   | 935   | 1,030 | 1,045 | 1,055 | 1,065  | 1,075  | 1,085  | 1,095  |
| Deductibility of charitable contributions (education)                                                             | 755   | 840   | 1,030 | 1,110 | 1,260 | 1,460 | 1,740  | 2,060  | 2,460  | 2,930  |
| 504 Training and Employment                                                                                       |       |       |       |       |       |       |        |        |        |        |
| Maximum tax on personal service income                                                                            | 730   | 665   | 1,335 | 1,265 | 1,655 | 2,105 | 2,640  | 3,270  | 4,085  | 5,110  |
| Credit for child and dependent care expenses                                                                      | 840   | 525   | 610   | 820   | 1,025 | 1,175 | 1,350  | 1,555  | 1,785  | 2,055  |
| Deduction/credit for employment of AFDC recipients and public assistance recipients under work incentive programs | 15    | 15    | 60    | 50    | 60    | 60    | 65     | 70     | 70     | 75     |
| General jobs credit                                                                                               | ---   | 2,460 | 1,895 | 190   | 85    | 25    | 15     | 10     | 10     | ---    |
| Targeted jobs credit                                                                                              | ---   | ---   | 140   | 125   | 275   | 180   | 20     | b      | ---    | ---    |
| Five-year amortization of child care facilities                                                                   | b     | ---   | ---   | ---   | ---   | ---   | ---    | ---    | ---    | ---    |
| 505 Other Labor Services                                                                                          |       |       |       |       |       |       |        |        |        |        |
| Exclusion of employee meals and lodging (other than military)                                                     | 330   | 300   | 325   | 350   | 380   | 410   | 445    | 485    | 525    | 570    |
| Investment credit for ESOP's                                                                                      | 245   | 255   | 385   | 700   | 770   | 820   | 895    | 580    | 195    | 115    |
| 506 Social Services                                                                                               |       |       |       |       |       |       |        |        |        |        |
| Deductibility of charitable contributions, other than education and health                                        | 4,255 | 4,685 | 5,715 | 6,155 | 7,520 | 9,015 | 10,825 | 13,055 | 15,755 | 19,020 |
| Exclusion of contributions to prepaid legal services plans                                                        | 5     | 10    | 15    | 20    | 35    | 10    | ---    | ---    | ---    | ---    |

(Continued)



TABLE 1. (Continued)

| Function and Subfunction                                                            | 1967  | 1968  | 1969  | 1970  | 1971  | 1972  | 1973  | 1974  | 1975  | 1976  |
|-------------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 550 HEALTH                                                                          |       |       |       |       |       |       |       |       |       |       |
| 551 Health Care Services                                                            |       |       |       |       |       |       |       |       |       |       |
| Exclusion of employer contributions for medical insurance premiums and medical care | 1,100 | 1,400 | 1,450 | 1,450 | 2,000 | 2,500 | 3,000 | 2,940 | 3,275 | 3,665 |
| Deductibility of medical expenses                                                   | 1,500 | 1,600 | 1,700 | 1,700 | 1,900 | 1,900 | 2,100 | 2,125 | 2,315 | 2,020 |
| Exclusion of interest on state and local hospital bonds                             | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| Deductibility of charitable contributions (health) <sup>f</sup>                     | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 1,045 | 930   |
| 556 Consumer and Occupational Health and Safety                                     |       |       |       |       |       |       |       |       |       |       |
| Expensing of removal of barriers to the handicapped                                 | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| 600 INCOME SECURITY                                                                 |       |       |       |       |       |       |       |       |       |       |
| 601 General Retirement and Disability Insurance                                     |       |       |       |       |       |       |       |       |       |       |
| Exclusion of social security benefits <sup>g</sup>                                  | ---   | 100   | 120   | 130   | 155   | 175   | 200   | 235   | 275   | 315   |
| Disability insurance benefits                                                       | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| OASI benefits for retired workers                                                   | 2,300 | 2,700 | 2,800 | 2,950 | 3,250 | 3,550 | 4,700 | 2,530 | 2,740 | 3,045 |
| Benefits for dependents and survivors                                               | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 410   | 450   | 495   |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                            | 1977  | 1978  | 1979  | 1980   | 1981   | 1982   | 1983   | 1984   | 1985   | 1986   |
|-------------------------------------------------------------------------------------|-------|-------|-------|--------|--------|--------|--------|--------|--------|--------|
| 550 HEALTH                                                                          |       |       |       |        |        |        |        |        |        |        |
| 551 Health Care Services                                                            |       |       |       |        |        |        |        |        |        |        |
| Exclusion of employer contributions for medical insurance premiums and medical care | 5,195 | 6,340 | 8,255 | 12,965 | 14,165 | 16,610 | 19,485 | 22,855 | 26,810 | 31,445 |
| Deductibility of medical expenses                                                   | 2,585 | 2,435 | 2,890 | 3,585  | 3,580  | 4,080  | 4,650  | 5,305  | 6,045  | 6,610  |
| Exclusion of interest on state and local hospital bonds                             | ---   | ---   | ---   | ---    | 580    | 670    | 785    | 880    | 980    | 1,070  |
| Deductibility of charitable contributions (health) <sup>f</sup>                     | 1,050 | 1,035 | 1,260 | 1,355  | 1,620  | 1,915  | 2,185  | 2,765  | 3,320  | 3,985  |
| 554 Consumer and Occupational Health and Safety                                     |       |       |       |        |        |        |        |        |        |        |
| Expensing of removal of barriers to the handicapped                                 | 5     | 10    | 10    | b      | ---    | ---    | ---    | ---    | ---    | ---    |
| 600 INCOME SECURITY                                                                 |       |       |       |        |        |        |        |        |        |        |
| 601 General Retirement and Disability Insurance                                     |       |       |       |        |        |        |        |        |        |        |
| Exclusion of social security benefits <sup>g</sup>                                  |       |       |       |        |        |        |        |        |        |        |
| Disability insurance benefits                                                       | 380   | 550   | 615   | 665    | 815    | 955    | 1,055  | 1,185  | 1,350  | 1,575  |
| OASI benefits for retired workers                                                   | 3,125 | 4,210 | 5,455 | 6,880  | 9,020  | 11,265 | 13,260 | 15,605 | 18,320 | 21,435 |
| Benefits for dependents and survivors                                               | 730   | 950   | 825   | 990    | 1,250  | 1,480  | 1,695  | 1,945  | 2,225  | 2,535  |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                           | 1967  | 1968  | 1969  | 1970  | 1971  | 1972  | 1973  | 1974  | 1975  | 1976  |
|--------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>601 General Retirement and Disability Insurance (continued)</b> |       |       |       |       |       |       |       |       |       |       |
| Exclusion of railroad retirement system benefits                   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 160   | 170   | 185   |
| Exclusion of workmen's compensation benefits                       | 150   | 180   | 210   | 210   | 320   | 375   | 400   | 520   | 505   | 555   |
| Exclusion of special benefits for disabled coal miners             | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 50    | 50    |
| Exclusion of sick and disability pay                               | 85    | 95    | 105   | 105   | 120   | 225   | 240   | 255   | 315   | 330   |
| Net exclusion of pension contributions and earnings                | 3,000 | 4,000 | 3,150 | 3,075 | 3,650 | 4,000 | 4,400 | 4,790 | 5,225 | 5,745 |
| Employer plans                                                     |       |       |       |       |       |       |       |       |       |       |
| Plans for self-employed and others                                 | 60    | 135   | 160   | 175   | 250   | 200   | 200   | 230   | 390   | 770   |
| Exclusion of other employee benefits                               |       |       |       |       |       |       |       |       |       |       |
| Premiums on group term life insurance                              | 400   | 400   | 440   | 440   | 500   | 550   | 600   | 680   | 740   | 805   |
| Premiums on accident and disability insurance                      | 25    | 25    | 25    | 25    | 30    | 35    | 40    | 40    | 50    | 55    |
| Additional exemption for the blind                                 | 10    | 10    | 10    | 10    | 10    | 10    | 10    | 15    | 10    | 20    |
| Additional exemption for the elderly                               | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 1,150 | 1,100 | 1,155 |
| Tax credit for the elderly                                         | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 100   | 130   | 120   |
| <b>603 Unemployment Compensation</b>                               |       |       |       |       |       |       |       |       |       |       |
| Exclusion of other employee benefits                               |       |       |       |       |       |       |       |       |       |       |
| Income of trusts to finance supplementary unemployment benefits    | 25    | 15    | 15    | 20    | 5     | 5     | 5     | 5     | 5     | 5     |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                           | 1977  | 1978  | 1979   | 1980   | 1981   | 1982   | 1983   | 1984   | 1985   | 1986   |
|--------------------------------------------------------------------|-------|-------|--------|--------|--------|--------|--------|--------|--------|--------|
| <b>601 General Retirement and Disability Insurance (continued)</b> |       |       |        |        |        |        |        |        |        |        |
| Exclusion of railroad retirement system benefits                   | 200   | 265   | 275    | 330    | 380    | 435    | 500    | 570    | 655    | 750    |
| Exclusion of workmen's compensation benefits                       | 705   | 835   | 1,035  | 1,165  | 2,675  | 3,260  | 3,965  | 4,825  | 5,870  | 7,145  |
| Exclusion of special benefits for disabled coal miners             | 50    | 50    | 50     | 50     | 100    | 105    | 110    | 120    | 130    | 140    |
| Exclusion of sick and disability pay                               | 50    | 75    | 140    | 185    | 170    | 170    | 170    | 170    | 170    | 170    |
| Net exclusion of pension contributions and earnings                | 8,715 | 9,940 | 11,325 | 12,925 | 23,605 | 27,905 | 32,930 | 38,855 | 45,850 | 54,100 |
| Employer plans                                                     |       |       |        |        |        |        |        |        |        |        |
| Plans for self-employed and others                                 | 1,305 | 1,650 | 1,920  | 2,125  | 2,105  | 2,305  | 2,525  | 2,770  | 3,040  | 3,345  |
| Exclusion of other employee benefits                               |       |       |        |        |        |        |        |        |        |        |
| Premiums on group term life insurance                              | 800   | 905   | 875    | 1,485  | 1,855  | 2,055  | 2,275  | 2,520  | 2,790  | 3,090  |
| Premiums on accident and disability insurance                      | 70    | 75    | 75     | 90     | 100    | 105    | 110    | 120    | 130    | 140    |
| Additional exemption for the blind                                 | 20    | 20    | 30     | 40     | 30     | 30     | 30     | 30     | 30     | 30     |
| Additional exemption for the elderly                               | 1,220 | 1,155 | 1,670  | 1,970  | 2,260  | 2,505  | 2,800  | 3,015  | 3,485  | 3,885  |
| Tax credit for the elderly                                         | 495   | 250   | 160    | 135    | 125    | 120    | 115    | 110    | 105    | 100    |
| <b>603 Unemployment Compensation</b>                               |       |       |        |        |        |        |        |        |        |        |
| Exclusion of other employee benefits                               |       |       |        |        |        |        |        |        |        |        |
| Income of trusts to finance supplementary unemployment benefits    | 10    | 10    | 10     | 10     | 20     | 20     | 25     | 30     | 30     | 35     |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                                                                           | 1967  | 1968  | 1969  | 1970  | 1971 | 1972  | 1973  | 1974  | 1975  | 1976  |
|----------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|-------|-------|------|-------|-------|-------|-------|-------|
| 603 <u>Unemployment Compensation</u><br>(continued)<br>Exclusion of untaxed<br>unemployment insurance<br>benefits                                  | 300   | 325   | 350   | 400   | 800  | 700   | 550   | 1,050 | 2,300 | 3,305 |
| 604 <u>Housing Assistance</u><br>Exclusion of interest on<br>state and local housing<br>bonds for rental housing                                   | ---   | ---   | ---   | ---   | ---  | ---   | ---   | ---   | ---   | ---   |
| 609 <u>Other Income Security</u><br>Exclusion of public assis-<br>tance benefits                                                                   | 50    | 50    | 50    | 50    | 65   | 65    | 70    | 75    | 105   | 115   |
| Deductibility of casualty<br>and theft losses                                                                                                      | 70    | 80    | 80    | 80    | 165  | 150   | 150   | 255   | 280   | 300   |
| Earned income credit                                                                                                                               | ---   | ---   | ---   | ---   | ---  | ---   | ---   | ---   | ---   | 290   |
| Excess of percentage standard<br>deduction over minimum<br>standard deduction                                                                      | 3,200 | 3,600 | 3,800 | 3,000 | 700  | 1,040 | 1,170 | 1,260 | 1,385 | 1,465 |
| 700 <u>VETERANS' BENEFITS AND SERVICES</u>                                                                                                         |       |       |       |       |      |       |       |       |       |       |
| 701 <u>Income Security for Veterans</u><br>Exclusion of veterans' dis-<br>ability compensation; <sup>1</sup><br>Exclusion of veterans'<br>pensions | 550   | 600   | 600   | 650   | 700  | 480   | 500   | 485   | 540   | 590   |
| 702 <u>Veterans' Education, Training<br/>and Rehabilitation</u><br>Exclusion of GI bill benefits                                                   | ---   | ---   | ---   | ---   | ---  | ---   | ---   | 290   | 255   | 330   |

(Continued)



TABLE 1. (Continued)

| Function and Subfunction                                                  | 1977  | 1978  | 1979  | 1980  | 1981  | 1982  | 1983  | 1984  | 1985  | 1986  |
|---------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>603 Unemployment Compensation (continued)</b>                          |       |       |       |       |       |       |       |       |       |       |
| Exclusion of untaxed unemployment insurance benefits                      | 2,745 | 1,200 | 1,780 | 2,495 | 5,275 | 4,530 | 4,440 | 4,335 | 4,460 | 4,610 |
| <b>604 Housing Assistance</b>                                             |       |       |       |       |       |       |       |       |       |       |
| Exclusion of interest on state and local housing bonds for rental housing | ---   | ---   | ---   | ---   | 430   | 555   | 680   | 800   | 940   | 1,095 |
| <b>609 Other Income Security</b>                                          |       |       |       |       |       |       |       |       |       |       |
| Exclusion of public assistance benefits                                   | 100   | 345   | 355   | 395   | 465   | 510   | 580   | 665   | 755   | 860   |
| Deductibility of casualty and theft losses                                | 345   | 360   | 435   | 590   | 715   | 895   | 1,015 | 1,195 | 1,410 | 1,665 |
| Earned income credit                                                      | 395   | 285   | 265   | 415   | 635   | 575   | 525   | 475   | 460   | 425   |
| Excess of percentage standard deduction over minimum standard deduction   | 1,285 | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   |
| <b>700 VETERANS' BENEFITS AND SERVICES</b>                                |       |       |       |       |       |       |       |       |       |       |
| <b>701 Income Security for Veterans</b>                                   |       |       |       |       |       |       |       |       |       |       |
| Exclusion of veterans' disability compensation                            | 655   | 840   | 905   | 1,050 | 1,300 | 1,575 | 1,860 | 2,135 | 2,460 | 2,825 |
| Exclusion of veterans' pensions                                           | 30    | 40    | 45    | 50    | 85    | 95    | 105   | 120   | 130   | 145   |
| <b>702 Veterans' Education, Training and Rehabilitation</b>               |       |       |       |       |       |       |       |       |       |       |
| Exclusion of GI bill benefits                                             | 255   | 200   | 195   | 160   | 180   | 160   | 130   | 110   | 90    | 75    |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                               | 1967  | 1968  | 1969  | 1970  | 1971  | 1972  | 1973  | 1974  | 1975  | 1976  |
|--------------------------------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>800 GENERAL GOVERNMENT</b>                                                                          |       |       |       |       |       |       |       |       |       |       |
| 806 Other General Government<br>Credits for political<br>contributions                                 | ---   | ---   | ---   | ---   | ---   | 100   | 100   | 10    | 40    | 40    |
| <b>850 GENERAL PURPOSE FISCAL ASSISTANCE</b>                                                           |       |       |       |       |       |       |       |       |       |       |
| <b>851 General Revenue Sharing</b>                                                                     |       |       |       |       |       |       |       |       |       |       |
| Exclusion of interest on<br>general purpose state and<br>local debt                                    | 1,800 | 2,000 | 2,200 | 2,300 | 2,600 | 2,900 | 3,300 | 3,865 | 3,805 | 4,170 |
| Deductibility of non-business<br>state and local taxes (other<br>than on owner-occupied<br>homes)      | 2,800 | 4,150 | 5,100 | 5,600 | 5,600 | 5,300 | 6,000 | 6,955 | 8,490 | 6,505 |
| <b>852 Other General Purpose Fiscal<br/>Assistance</b>                                                 |       |       |       |       |       |       |       |       |       |       |
| Tax credit for corporations<br>receiving income from doing<br>business in United States<br>possessions | 70    | 80    | 85    | 80    | 80    | 80    | 80    | 355   | 245   | 240   |
| Exclusion of income earned by<br>individuals in United States<br>possessions                           | 10    | 10    | 10    | 10    | 10    | 10    | 10    | ---   | ---   | ---   |
| <b>900 INTEREST</b>                                                                                    |       |       |       |       |       |       |       |       |       |       |
| <b>901 Interest on the Public Debt</b>                                                                 |       |       |       |       |       |       |       |       |       |       |
| Deferral of interest on<br>savings bonds                                                               | ---   | ---   | ---   | ---   | ---   | ---   | ---   | ---   | 525   | 605   |

(Continued)

TABLE 1. (Continued)

| Function and Subfunction                                                                          | 1977  | 1978  | 1979   | 1980   | 1981   | 1982   | 1983   | 1984   | 1985   | 1986   |
|---------------------------------------------------------------------------------------------------|-------|-------|--------|--------|--------|--------|--------|--------|--------|--------|
| 800 GENERAL GOVERNMENT                                                                            |       |       |        |        |        |        |        |        |        |        |
| 806 Other General Government                                                                      |       |       |        |        |        |        |        |        |        |        |
| Credits for political contributions                                                               | 40    | 60    | 80     | 100    | 100    | 80     | 80     | 80     | 100    | 80     |
| 850 GENERAL PURPOSE FISCAL ASSISTANCE                                                             |       |       |        |        |        |        |        |        |        |        |
| 851 General Revenue Sharing                                                                       |       |       |        |        |        |        |        |        |        |        |
| Exclusion of interest on general purpose state and local debt                                     | 4,785 | 5,395 | 5,365  | 5,880  | 5,930  | 6,480  | 7,305  | 7,980  | 8,560  | 9,045  |
| Deductibility of non-business business state and local taxes (other than on owner-occupied homes) | 8,095 | 8,505 | 10,935 | 14,665 | 18,405 | 23,060 | 28,060 | 33,670 | 40,405 | 48,485 |
| 852 Other General Purpose Fiscal Assistance                                                       |       |       |        |        |        |        |        |        |        |        |
| Tax credit for corporations receiving income from doing business in United States possessions     | 285   | 485   | 685    | 780    | 1,005  | 1,095  | 1,200  | 1,320  | 1,455  | 1,600  |
| Exclusion of income earned by individuals in United States possessions                            | ---   | ---   | ---    | ---    | ---    | ---    | ---    | ---    | ---    | ---    |
| 900 INTEREST                                                                                      |       |       |        |        |        |        |        |        |        |        |
| 901 Interest on the Public Debt                                                                   |       |       |        |        |        |        |        |        |        |        |
| Deferral of interest on savings bonds                                                             | 565   | 625   | 615    | 290    | -75    | 335    | 335    | 335    | 335    | 335    |
| ----- (Continued) -----                                                                           |       |       |        |        |        |        |        |        |        |        |

TABLE 1. (Continued)

| Function and Subfunction | 1967   | 1968   | 1969   | 1970   | 1971   | 1972   | 1973   | 1974   | 1975   | 1976   |
|--------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| TOTAL                    |        |        |        |        |        |        |        |        |        |        |
| Revenue Losses           | 36,550 | 44,140 | 46,635 | 43,945 | 51,710 | 59,810 | 65,370 | 82,015 | 92,855 | 97,365 |
| Number of Items          | 50     | 51     | 52     | 53     | 55     | 59     | 59     | 71     | 76     | 80     |
| -----                    |        |        |        |        |        |        |        |        |        |        |
| (Continued)              |        |        |        |        |        |        |        |        |        |        |

TABLE 1. (Continued)

| Function and Subfunction | 1977    | 1978    | 1979    | 1980    | 1981    | 1982    | 1983    | 1984    | 1985    | 1986    |
|--------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| TOTAL                    |         |         |         |         |         |         |         |         |         |         |
| Revenue Losses           | 113,455 | 123,470 | 149,815 | 181,480 | 228,620 | 266,280 | 306,435 | 350,330 | 403,725 | 465,290 |
| Number of Items          | 85      | 84      | 92      | 92      | 104     | 104     | 103     | 103     | 100     | 98      |

SOURCES: Estimates of Federal Tax Expenditures, prepared by the Staffs of the Treasury Department and Joint Committee on Taxation (June 1, 1973, July 8, 1975, March 15, 1976, March 15, 1977, March 14, 1978, March 15, 1979, March 6, 1980, March 16, 1981); and Tax Analysts and Advocates, Tax Notes (April 15, 1974).

NOTE: The estimates were prepared only on a calendar year basis until 1973. The estimates for calendar years 1967 to 1973 correspond roughly to fiscal years 1968 to 1974.

- a. All estimates are based on the tax law in effect at the time the estimates were made. Individual and corporate tax expenditures for each year are combined.
- b. Less than \$2.5 million.
- c. Includes capital gains from iron ore for years 1967 to 1977.
- d. Included with capital gains from coal for years 1967 to 1977.
- e. Includes charitable contributions for health for years 1967 to 1974.
- f. Included with other charitable contributions for years 1967 to 1974.
- g. Dependents and survivors benefits, additional exemption for the elderly and the tax credit for the elderly included with OASI benefits for retired workers for years 1967 to 1973.
- h. The figures in the table indicate the effect of the earned income credit on receipts. The effect on outlays is \$1,165 million in 1976, \$1,015 million in 1977; \$945 million in 1978; \$840 million in 1979; \$1,695 million in 1980; \$1,205 million in 1981; \$1,115 million in 1982; \$1,030 million in 1983; \$955 million in 1984; \$855 million in 1985; and \$815 million in 1986.
- i. Includes veterans' pensions and exclusion of GI bill benefits for years 1967 to 1973.



TABLE 2. CHANGES IN THE TAX EXPENDITURE BUDGET, FISCAL YEARS 1967 TO 1986

|                                                                              | 1967 | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 |
|------------------------------------------------------------------------------|------|------|------|------|------|------|------|------|------|------|
| Total Number of<br>Tax Expenditures                                          | 50   | 51   | 52   | 53   | 55   | 59   | 59   | 71   | 78   | 80   |
| Number Added<br>Because Of                                                   |      |      |      |      |      |      |      |      |      |      |
| Definitional<br>Changes                                                      |      |      |      |      |      |      |      |      |      |      |
| Items previously<br>in the tax code<br>but not included<br>in the budget     |      |      |      |      |      |      |      | 11   | 4    |      |
| Subdivision of<br>items previously<br>in the budget                          |      | 1    |      |      |      |      |      | 1    | 3    |      |
| Legislative<br>Action                                                        |      |      | 1    | 1    | 2    | 4    |      | 1    | 1    | 2    |
| Number Subtracted<br>Because Of                                              |      |      |      |      |      |      |      |      |      |      |
| Definitional<br>Changes                                                      |      |      |      |      |      |      |      |      |      |      |
| Items still in<br>the tax code<br>but no longer<br>included in<br>the budget |      |      |      |      |      |      |      | 1    |      |      |
| Combination of<br>previously<br>separate items                               |      |      |      |      |      |      |      |      |      |      |
| Legislative<br>Action                                                        |      |      |      |      |      |      |      |      | 1    |      |

(Continued)

TABLE 2. (Continued)

|                                                                  | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 19 |
|------------------------------------------------------------------|------|------|------|------|------|------|------|------|------|----|
| Total Number of Tax Expenditures                                 | 85   | 84   | 92   | 92   | 104  | 104  | 103  | 103  | 100  |    |
| Number Added Because Of                                          |      |      |      |      |      |      |      |      |      |    |
| Definitional Changes                                             |      |      |      |      |      |      |      |      |      |    |
| Items previously in the tax code but not included in the budget  |      |      | 1    |      |      |      |      |      |      |    |
| Subdivision of items previously in the budget                    |      | 1    | 1    | 1    | 10   |      |      |      |      |    |
| Legislative Action                                               | 5    | 1    | 6    |      | 5    |      |      |      |      |    |
| Number Subtracted Because Of                                     |      |      |      |      |      |      |      |      |      |    |
| Definitional Changes                                             |      |      |      |      |      |      |      |      |      |    |
| Items still in the tax code but no longer included in the budget |      |      |      |      | 2    |      |      |      |      |    |
| Combination of previously separate items                         |      |      |      |      |      |      |      |      |      |    |
| Legislative Action                                               |      | 3    |      | 1    | 1    |      | 1    |      | 3    |    |

SOURCE: Table 1.

earlier years are not formally revised to reflect these changes, except for the most recent year or two in which the old and new estimates overlap.

Changes in Other Tax Provisions. Estimates of tax expenditures may change when tax rates or other basic structural features of the tax code are changed, even if there are no explicit modifications in the tax expenditure provisions themselves. If tax rates are reduced across the board, for example, the measured revenue loss from tax expenditures will also be reduced, since special deductions and exclusions will be measured against lower rates.<sup>4</sup> Similarly, increases in the standard deduction (zero bracket amount) will reduce the revenue loss from tax expenditures that take the form of itemized deductions.

#### OUTLAY EQUIVALENTS

In order to make precise comparisons between tax expenditures and direct outlays programs for program analysis purposes, some adjustments in the tax expenditure estimates can be useful. If the government is trying to decide between a tax expenditure and a direct outlay subsidy program, for example, it may want to look at alternatives that provide the same after-tax benefits to recipients. The purpose of most subsidies is to influence behavior, and for this purpose the net amount of the subsidy after taxes is usually most important. But if the subsidy is taxable in one form but not in the other, the subsidies are not equivalent. The taxable subsidy is less valuable to the recipient because some portion of it is returned to the government in taxes, while its net cost to the government is less for the same reason.

The 10 percent investment tax credit, for example, is worth more to businesses than a taxable direct grant of the same amount would be, since businesses do not have to pay any tax on the amount of the credit. Accordingly, if the government were to substitute a taxable direct grant program for the investment tax credit, and wanted to keep the after-tax benefit to the recipients the same,

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4. There may also be a separate behavioral response from changes in tax rates, since the incentive for taxpayers to use special deductions or exclusions is reduced if they are worth less in tax savings. This effect may or may not be explicitly taken into account in the estimates, depending on how reliably the behavioral response can be estimated.

the total outlay cost--the "outlay equivalent"--would have to be larger than the revenue loss from the investment tax credit to cover the tax on the grant.

Some tax subsidies are, in effect, taxable. Businesses that use the targeted jobs tax credit, for example, must subtract the amount of the credit from the deduction for wages they would otherwise be allowed for tax purposes. This "basis adjustment" is equivalent to including the amount of the credit in income and

TABLE 3. HOUSING AND ENERGY TAX EXPENDITURES AND OUTLAY EQUIVALENTS, FISCAL YEARS 1980-1982 (In millions of dollars)

|                           | 1980   | 1981   | 1982   |
|---------------------------|--------|--------|--------|
| <b>Housing</b>            |        |        |        |
| Owner-occupied housing    |        |        |        |
| Tax expenditures          | 25,335 | 31,565 | 39,725 |
| Outlay equivalents        | 26,840 | 33,170 | 41,655 |
| Rental Housing            |        |        |        |
| Tax expenditures          | 890    | 1,030  | 1,195  |
| Outlay equivalents        | 1,965  | 2,155  | 2,410  |
| Total                     |        |        |        |
| Tax expenditures          | 26,225 | 32,595 | 40,920 |
| Outlay equivalents        | 28,805 | 35,325 | 44,065 |
| <b>Energy</b>             |        |        |        |
| Conservation <sup>a</sup> |        |        |        |
| Tax expenditures          | 660    | 785    | 850    |
| Outlay equivalents        | 720    | 825    | 895    |
| Supply <sup>b</sup>       |        |        |        |
| Tax expenditures          | 4,500  | 6,020  | 6,535  |
| Outlay equivalents        | 7,715  | 9,520  | 10,875 |
| Total                     |        |        |        |
| Tax expenditures          | 5,160  | 6,805  | 7,485  |
| Outlay equivalents        | 8,435  | 10,345 | 11,770 |

a. Includes exemption from excise tax for buses and bus parts.

b. Includes exemption from excise tax for alcohol fuels.

subjecting it to tax. The cost in outlays of an equivalent taxable direct grant program would thus be the same as the revenue loss from the credit, with no extra amount for the tax.

Special Analysis G in the fiscal year 1982 budget contains a more systematic illustration of this approach. In a section prepared by the Treasury Department, the outlay equivalents of the tax expenditures for energy and housing are estimated, and then compared with direct budget outlays for those purposes.<sup>5</sup> As indicated in Table 3, which has been adapted from information in Special Analysis G, the outlay equivalents of tax expenditures are significantly higher than the tax expenditures themselves. Since the tax expenditure subsidies are tax free, an equivalent outlay would usually have to be higher to be worth the same amount to the recipient, and the budget cost of the equivalent outlay would also be higher.

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5. Budget of the United States Government, Fiscal Year 1982, Special Analyses, pp. 234-38 (January 1981).



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### CHAPTER III. TAX EXPENDITURE SUBSIDIES, GENERAL TAX CUTS, AND DIRECT EXPENDITURE SUBSIDIES

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Tax expenditure subsidies can be viewed as alternatives or supplements to federal spending, loan, or regulatory programs with similar goals. The targeted jobs tax credit, for example, is aimed in large measure at providing jobs for hard-core unemployed youths, a goal shared by the Job Corps program and the proposed subminimum wage for teenagers. There are tax credits, grants, and loans for residential energy conservation. Both the Export-Import Bank and the Domestic International Sales Corporation (DISC) tax provisions subsidize U.S. exports.

But tax expenditures can also be viewed as alternatives to more general tax cuts. Whenever the Congress faces a decision on cutting taxes, it has a choice between general across-the-board cuts--reductions in rates, bracket widening, increases in the zero bracket amount (standard deduction), increases in personal exemptions, and the like--and more narrowly targeted cuts that frequently take the form of tax expenditures.

This chapter reviews some of the considerations that may be relevant in choosing between tax expenditures and general tax cuts, and between tax expenditures and other forms of federal subsidies.

#### TAX EXPENDITURES AND GENERAL TAX CUTS

The effects of tax expenditures are very similar to those of federal spending and loan programs, so it is useful analytically to consider tax expenditures as alternatives to spending programs. In terms of actual legislative decisions, however, changes in tax expenditures are normally considered in the context of tax legislation rather than spending legislation, since committee jurisdictional problems can make it difficult to work out direct trade-offs between tax and spending programs. The choice is thus frequently between tax expenditures and more general tax cuts. Whenever the Congress is considering a large tax cut, for example, it must determine how much of the tax cut to devote to relatively broad

general cuts and how much to devote to new or expanded tax expenditure provisions. If repeal or reduction of existing tax expenditures is being considered, one possible use of the additional revenue would be to return it to taxpayers in the form of an across-the-board tax cut.

The choice between general tax cuts and tax expenditures has been on the Congressional agenda frequently during the past decade. Because of the interaction of inflation with the graduated rate structure of the individual income tax, regular tax cuts have been necessary to hold taxes relatively constant as a percentage of personal income. Starting with the Tax Reform Act of 1969, large personal and business tax cuts were approved in 1971, 1975, 1976, 1977, 1978, and 1981. The Economic Recovery Tax Act of 1981 may signal a significant break in that pattern, however. The act provides for an across-the-board reduction in individual income tax rates of 23 percent over the 1981 to 1984 period, followed by indexing of the individual income tax for inflation starting in 1985. In addition, the act provides for very large reductions in business taxes over the next five years, as more generous business depreciation allowances are phased in.

The Congress has thus chosen to provide large general tax cuts, but it has not yet fully determined how those cuts are to be financed. The 1981 tax act will reduce taxes by an estimated \$268 billion below the level they would otherwise have reached in fiscal year 1986, well in excess of the spending reductions that have been enacted thus far. Further reductions in spending will, therefore, be necessary if the goal of a balanced budget is to be reached by fiscal year 1984. Reductions in tax expenditures could also be used to fill this gap. Instead of simultaneous conversion of tax expenditure reductions into general tax cuts, the tax expenditure reductions could be used to finance the future-year tax cuts that have already been enacted.

Additionally, tax expenditure reductions could be used to fund still further reductions in general tax rates. The individual tax cuts enacted in 1981 actually do little more than hold the tax burden constant over the next few years, offsetting the tax increases that would otherwise have occurred because of inflation-induced increases in the individual income tax and scheduled increases in Social Security taxes.

It is, therefore, worth noting some of the considerations that arise in choosing between tax expenditures and general tax cuts.

In general terms, the choice is between relatively small per-taxpayer savings for large numbers of taxpayers and larger per-taxpayer savings for a more narrowly defined group of taxpayers. More specifically, however, the choice may turn on the possible effects of different alternatives on taxpayer behavior and on marginal tax rates.

#### Effects on Taxpayer Behavior

Because general across-the-board tax cuts usually involve small per-taxpayer savings, and, because the cuts do not specifically attempt to change taxpayer behavior, they normally do not alter taxpayer behavior in measurable ways. If the cuts include reductions in marginal tax rates, however, incentives to save, work, and invest may increase, leading to important changes in behavior. This is especially true for the highest marginal rates, such as the former top marginal rate of 70 percent on investment income, and the high rates that apply to low-income workers because of the phase-out of the earned income credit as income rises.<sup>1</sup>

Proponents of incentive-type tax expenditures usually argue that the targeted tax provisions that they propose will have greater effects on taxpayer behavior than broad across-the-board tax cuts. Those who advocate excluding a certain amount of interest income from tax, for example, suggest that this would do more to encourage increased saving than a cut in marginal tax rates with the same revenue loss. Opponents argue that most targeted savings incentives simply shift existing savings into the tax-favored forms without increasing overall net saving.

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1. The earned income credit is equal to 10 percent of the first \$5,000 of income, but it gradually phases down as income exceeds \$6,000, declining to zero for families with incomes over \$10,000. Thus, for each \$100 of extra income that a family earns above \$6,000, the earned income credit declines by \$12.50. This is equivalent to a marginal tax rate of 12.5 percent. When added to the marginal tax rates that result from the regular tax schedule, payroll taxes, and the phaseout of income-tested benefits from AFDC, food stamps, housing assistance, and the like, the cumulative marginal tax rates for such families can be well above 50 percent.

Generally, tax subsidies that favor a particular kind of economic activity will result in more resources being devoted to that activity, but this is usually a reallocation of existing resources rather than any overall increase. At least in the short run, targeted tax subsidies are likely to have about the same effect on overall economic activity as a general tax cut of the same size. Just as with a general tax cut, some taxpayers or sectors of the economy will be better off, but others will be worse off.

Some tax subsidies may serve to offset or compensate for other distortions in the economy, so that the reallocation of resources they represent may leave the economy better off in the long run. Accelerated depreciation and the investment tax credit, for example, may help to compensate for the overtaxation of corporate income that many economists believe results from the corporate income tax and the failure to adjust business depreciation allowances for inflation. Using one set of distortions to offset another, however, may require a greater understanding of how the economy works than now exists. Moreover, the kind of precise guiding of taxpayer behavior that, in theory, is necessary can be difficult to accomplish. It is hard to predict in advance how taxpayers will react to a specific provision, and to design and administer provisions that will assure those effects. Tax-exempt bond financing of industrial pollution control, for example, may well be encouraging "end of the pipe" control devices when more efficient control of pollution emissions could be achieved by basic changes in manufacturing processes or the treatment of raw materials. The residential energy conservation tax credit may simply have driven up the cost of home insulation and other energy-saving devices by the amount of the credit, while adding little to the incentive for energy conservation already provided by higher energy prices.

Whatever the merits of incentive-type tax subsidies, they represent an attempt by the federal government to induce taxpayers to do things they would not otherwise do in exchange for a tax saving. When compared to the alternative of a federal spending or regulatory program, this means of influencing behavior may appear less intrusive. But compared to a more general tax cut, it represents greater federal involvement in taxpayer decisions, and less reliance on market forces. With general tax cuts, taxpayers receive the tax savings automatically, and they can use them as they wish. With tax expenditures, the tax savings go only to those in specified circumstances, or who act in specified ways.

### Marginal Tax Rates

Tax expenditures can be viewed as both a cause and an effect of high marginal tax rates. Because tax expenditures remove a large share of income from the tax base, tax rates must be higher on the income that is left to raise the same amount of revenue. And because marginal tax rates are so high, there is continual pressure for tax expenditures that can shield income from those high rates.

Effective marginal tax rates have increased substantially overall in recent years, even though there has been no legislated increase in tax rates. In 1969, fewer than 6 percent of all tax returns had income taxed at marginal rates of more than 30 percent. By 1979, more than 14 percent of returns had income taxed at rates above that level. The share of total personal income taxed at above 30 percent rose from less than 6 percent in 1969 to more than 8 percent in 1979.<sup>2</sup>

Most of this increase occurred because inflation and real growth in incomes pushed more and more income into the higher tax brackets. This "bracket creep" could have been offset by reductions in marginal tax rates, widening of rate brackets, or some combination, but it was not. Only one of the tax cuts in the 1970s involved any change in rates, and that one, in 1978, offset only one year's bracket creep. At the same time, an increasing share of personal income was being excluded from the tax base. The percentage of personal income excluded from adjusted gross income by law or regulation rose from 13.5 percent in 1969 to 18.6 percent in 1979. Income tax credits offset 1.5 percent of personal income in 1979, up from 0.5 percent in 1969.<sup>3</sup> Taxes were also reduced by increases in the personal exemption and the standard deduction, which are considered part of the normal tax structure rather than tax expenditures.

The emphasis in the 1970s on narrowing the tax base by increasing deductions, exclusions, exemptions, and credits rather than cutting tax rates reflected in part a desire to concentrate more of the tax savings on those with low and moderate incomes.

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2. Eugene Steuerle and Michael Hartzmark, "Individual Income Taxation 1947-79," OTA Paper 48 (April 1981), Office of Tax Analysis, Department of the Treasury, Table A-5, p. 36.
  3. Ibid., Table 1, p. 8 and Table 2, p. 14.



Increases in personal exemptions and the standard deduction, for example, provide greater tax savings to lower-income taxpayers than do across-the-board rate cuts. Many tax expenditures, however, especially those that take the form of deductions or exclusions rather than credits, provide substantial tax savings to higher-income taxpayers. The expansion of tax expenditures during the 1970s thus extended significant tax relief to higher-income taxpayers as well, even though there were no reductions in rates until 1978.

It is clear that tax expenditures can serve to reduce the burden of high marginal tax rates on taxpayers. A number of tax expenditures are frequently combined into "tax shelters" for wealthy investors. The oil depletion allowance, the deduction for intangible oil and gas drilling expenses, accelerated depreciation allowances, the investment tax credit, and the lower rates on capital gains are examples. These tax shelters enable oil drillers, real estate developers, manufacturers, and others to obtain the investment funds they need by, in effect, selling the tax savings to high-bracket taxpayers.

While this serves to ease the burden of high marginal rates on many taxpayers, this method can create significant "transaction costs" and economic inefficiencies. Reducing marginal tax rates directly, as the Congress has now done, can eliminate some of these inefficiencies in the investment process, channeling more resources into productive investment. This is especially true with respect to the top 70 percent marginal rate on investment income, which has induced many investors to seek tax shelters.

There is thus a fairly direct trade-off between rate reductions and tax expenditures. The more rates are reduced, the less is the incentive to use tax expenditures to ease the burden of high rates. But the more tax expenditures erode the income tax base, the higher rates must be on the income that remains to be taxed.

#### TAX SUBSIDIES AND DIRECT EXPENDITURE SUBSIDIES

Tax subsidies can also serve as alternatives to spending or loan programs. Almost any feature that is included in a spending or loan program can be duplicated in a tax subsidy. Providing tax subsidies in the form of credits rather than deductions, and including the credit in taxable income, can assure that the value of the tax subsidy is the same as that of an equivalent direct

grant. Making the credit refundable, as discussed below, can extend the subsidy to nontaxpayers, both individuals and businesses. Providing the subsidy in the form of a deferral of tax liability makes it the equivalent of a loan program. While no interest is normally charged on tax deferrals, it could be if the Congress wished. These are all questions of program design; the Congress can make tax subsidies look and work as much or as little like direct spending and loan programs as it chooses.

There are some practical differences between tax and direct expenditure subsidies, however, that may lead the Congress to choose one rather than the other. It can be difficult to extend tax subsidies to individuals and businesses that do not pay taxes; tax subsidies come under the jurisdiction of different committees than spending programs; they are subject to less precise control in the budget process; administrative control and review tends to be less detailed; and the beneficiaries of tax subsidies may prefer to receive subsidies in that form. Depending on the goals being sought, these can be viewed as either advantages or disadvantages.

#### Nontaxpayers

While it is possible to extend the benefits of tax subsidies to nontaxpayers, it can be cumbersome to do so. The most direct way is to provide the subsidy in the form of a refundable tax credit. This is a credit against taxes due that is paid directly in cash, or refunded, if the recipient does not owe enough taxes to use up the credit. The only refundable tax expenditure now in the law is the earned income credit paid to low-income workers with dependents, but it has frequently been suggested that the investment tax credit and other credits be made refundable as well.

Making tax credits refundable would be consistent with the underlying rationale for most such provisions, which is to provide a subsidy to the recipient. Since eligibility for nontax subsidies does not depend on whether or not the recipient has taxable income, subsidies provided through the tax code, proponents argue, should not be subject to this kind of limitation either. In addition, making tax credits refundable would eliminate the need for the current complex rules that specify the order in which credits must be taken, and provide for the carryback and carryforward of unused credits.

A number of objections have been raised to making credits refundable, including the extra cost, the administrative burden on

the IRS, and the impropriety of "bailing out" money-losing businesses. But the underlying concern on the part of many tax policymakers appears to be that making more and more credits refundable could eventually result in a large share of federal spending programs being run through the tax system, diverting the Treasury and the IRS from their traditional revenue-raising tasks.

In the case of most businesses, refundable credits would present few administrative problems. The records needed are readily available, and the beneficiaries are easy to identify and keep track of.

Nontaxpaying individuals, especially those with low incomes, are more difficult to deal with through the tax system. People whose incomes are so low they do not have to pay taxes usually do not have to file tax returns, so the IRS may have no record of their existence. It is thus hard to inform them of their possible eligibility for a subsidy. Once they learn about the subsidy, they may have difficulty with the forms and paperwork necessary to establish their eligibility, and the IRS has relatively few resources to provide them with assistance. Many low-income nontaxpayers also have considerable fear and skepticism about dealing with the IRS, and may thus be reluctant to apply for an IRS-administered subsidy. It may also be a hardship for them to have to wait until tax returns can be filed to obtain the subsidy. While attempts have been made to have the earned income tax credit reflected currently in withholding, there have been administrative problems with this approach. In the case of subsidies for low-income individuals, therefore, it may be preferable to provide the subsidy in the form of a direct grant administered by an agency with more experience in dealing with low-income people.

There are also some less direct ways of extending the benefits of tax subsidies to those who have little or no taxable income. Tax credits and deductions can be carried back to offset tax liability from earlier years, or carried forward to offset possible future liability. The present value to the beneficiary of any tax saving is reduced, however, if it is not actually received until some year in the future.

Leasing arrangements are another possibility. A business with low tax liability can lease its equipment from a bank or other firm with enough tax liability to take advantage of the investment tax credit and other tax subsidies, and obtain at least part of the benefit of the subsidy in the form of reduced lease payments. The

Economic Recovery Tax Act of 1981 eased very significantly the tax rules that apply to leasing, clearing the way for a substantial expansion in this activity. Even with these more liberal rules, however, there can be transaction costs and economic inefficiencies associated with leasing that can make this a less than ideal solution.

Another way of circumventing the nonrefundability of present business tax credits is through acquisitions and mergers. Firms with large accumulations of unused tax credits are frequently attractive candidates for mergers with firms with large tax liabilities. How the benefits of the tax credits are then divided depends on the terms of the arrangement between the companies involved.

#### Committee Jurisdictions

Tax subsidies come under the jurisdiction of the House Committee on Ways and Means and the Senate Committee on Finance. The rules of both Houses permit legislation to be referred jointly to two or more committees, so that it is possible for other committees to consider tax subsidies as well. The Rules of the House of Representatives specifically provide for a degree of joint responsibility:

Each standing committee of the House shall have the function of reviewing and studying on a continuing basis the impact or probable impact of tax policies affecting subjects within its jurisdiction . . . .<sup>4</sup>

But legislative jurisdiction lies with the tax-writing committees.

Proponents of a new program may prefer to cast it in the form of a tax subsidy in order to have it considered by the tax committees. This is especially likely if a proponent happens to be a member of one of those committees. More generally, however, the tax committees may simply be viewed as a more sympathetic forum, or the committees that would have jurisdiction over a direct spending subsidy may be hostile to the proposal or subject to budgetary constraints. Those proposing the subsidy may also not want to have

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4. Rules of the House of Representatives, Rule X(2)(d).

it administered by the executive agency that would be in charge of the program if it took the form of a direct grant.

Specialization and Expertise. It is often argued that it is inappropriate to have housing, health, education, employment, energy, agriculture, and other subsidies legislated by the tax committees, since they lack expertise in those specialized subject areas. The Mortgage Subsidy Bond Tax Act of 1980, for example, which placed limits on the use of tax-exempt bonds to finance single-family housing, required the tax committees to deal with many issues that were more familiar to the committees with jurisdiction over housing. But the tax committees have substantial experience in dealing with a number of direct spending programs. They have jurisdiction over major health and welfare programs, unemployment compensation, and Social Security, and have dealt extensively in recent years with energy issues. To the extent that the tax committees lack experience or expertise in a specific area, it may be possible through the process of joint referral to have tax subsidy proposals reviewed by the committees that have this expertise.

#### Budgetary Control

Budget Act Requirements. The Budget Act requires that five-year projections of the estimated levels of tax expenditures by major budget functional category be included each year in the Budget Committee reports accompanying the First Concurrent Resolution on the Budget. In addition, committee reports on all bills providing for new or increased tax expenditures must include five-year estimates of the revenue loss from those provisions. Beyond that, however, there are no direct controls over tax expenditures in the budget process. The budget resolutions themselves do not set targets for tax expenditures by budget functional categories, as they do for direct spending programs. Nor are the tax committees allocated target ceilings for tax expenditures, as all committees are in the case of spending programs under their jurisdiction.

Revenue Floors. Nonetheless, the budget process does impose one very important constraint on tax expenditures. Once the overall revenue floor is established by the second concurrent resolution, any legislation with a revenue loss that would reduce total revenues below the floor is subject to a point of order. This of course applies to all revenue-reducing legislation, not just legislation that provides special-purpose tax subsidies in the



form of tax expenditures. But the revenue floor sets up a "zero-sum game" in which all revenue-reducing bills must compete for the limited amount of tax reduction permitted by the budget resolution. If the budget resolution contemplates a tax cut of \$20 billion, for example, the cut may take the form of a broad, across-the-board rate cut, a series of special-purpose tax subsidies, or some combination, but the total tax cut cannot exceed \$20 billion. Elimination or reduction of existing tax expenditures would, of course, create room for additional general tax cuts. Across-the-board cuts that provide relatively modest tax relief to large numbers of taxpayers must therefore compete with tax subsidies that provide larger per-taxpayer savings to fewer taxpayers. While this kind of limit on the total amount of revenue-reducing legislation that the Congress may approve does not limit tax expenditures directly, it does create a situation in which they are likely to be subject to closer scrutiny.

The control over tax expenditures that results from the overall revenue floor is actually similar in many respects to the control over direct spending that is imposed by overall spending ceilings. While the second budget resolution does include limits on spending by major functional category, spending legislation is not subject to a point of order if it would breach those function-by-function ceilings. It is only the overall spending totals that are binding, just as it is only the overall revenue floor that limits tax expenditures or other tax cuts. The more detailed breakdown of spending categories may help to highlight potential breaches of the spending ceiling as bills move through the legislative process, but it is only the last spending bill that gets caught by the spending ceiling, just as it is only the last revenue-reducing bill that gets caught when the revenue floor is reached.

Reconciliation. Another budgetary control tool is the process called reconciliation, under which changes in spending and revenues can be ordered to reconcile current law spending and revenue levels with the overall totals agreed upon in the budget resolution. Reconciliation was first used in 1980 and resulted in fiscal year 1981 deficit reductions of approximately \$8.2 billion, \$4.6 billion from reduced outlays and \$3.6 billion from additional revenues. Most of the additional fiscal year 1981 revenues came from a "cash management" speed-up of tax collections, but substantial future-year revenues were projected from the phase-out of tax-free mortgage subsidy bonds.

Reconciliation was greatly expanded in 1981. Fiscal year 1982 outlay reductions from reconciliation are estimated at \$35 billion. Unlike 1980, however, reconciliation in 1981 did not include any revenue measures.

Nonetheless, as the 1980 experience demonstrates, reconciliation can be used to increase revenues as well as to reduce outlays. It cannot require changes in specific tax expenditures, however, just as it cannot require specific changes in spending programs. The decision on how to raise revenues is left to the tax committees. The revenue increases can come from across-the-board tax increases, increased user charges and excise taxes, reductions in tax expenditures, or other tightening and reform measures.

Visibility. It is often argued that tax subsidies have less visibility in the legislative and budget process than do direct spending programs, and that they are, therefore, subject to less regular and detailed scrutiny. This was certainly true in the past, but it has become somewhat less so in recent years. The tax expenditure budget, which lists all tax expenditures and the estimated revenue losses associated with them, is published each year along with the President's budget in January. It includes revenue loss estimates for the upcoming fiscal year and the two prior years. Two or three months later, five-year projections of estimated tax expenditure revenue losses are published by the Joint Committee on Taxation for the two Congressional tax-writing committees. These five-year projections of all tax expenditures are then included in the Budget Committee reports on the first concurrent resolution, and published separately by the CBO (see Appendix Table A-1).

Each bill increasing or reducing tax expenditures is accompanied by a report giving an estimate of the five-year loss or gain from the change, just as spending bills are accompanied by five-year cost estimates. Changes in tax expenditures have the same effect on the federal deficit as do any other tax or spending changes, and thus receive whatever attention and scrutiny that entails.

One problem with tax expenditures is that their cost in lost revenues can increase sharply and unexpectedly if economic or demographic conditions should change, since they are, in effect, "entitlement" programs that are automatically available to whoever meets the statutory eligibility requirements. Like Social Security, Medicare, and other entitlement spending programs, there

is no overall limit on the costs of the program. While it is usually possible to make reasonably good estimates of future costs, there are cases in which higher costs can occur with little warning. The use of tax-exempt bonds to finance single-family housing grew rapidly in late 1978 and early 1979, for example, threatening multibillion dollar annual revenue losses until the Congress stepped in to impose limits.<sup>5</sup> Tax-exempt industrial revenue bonds have been used to a much greater extent than previously available data suggested, since most of the bonds are not reported beyond the state level, if at all.<sup>6</sup>

Like entitlement spending programs, therefore, the future costs of tax expenditures are not as visible and predictable as those of programs with statutory ceilings. The early signs of cost increases can be especially difficult to detect with tax expenditures, since total tax collections may fall below expectations for a whole host of reasons. It is usually not possible to tie a decline in revenues directly to increased use of a particular tax expenditure, whereas it becomes quickly apparent when spending for a particular entitlement spending program increases.

Periodic Review. Tax subsidies are not regularly reviewed in the way that spending programs subject to annual appropriations or periodic reauthorization are. Most spending programs are not subject to detailed full-scale review on a regular basis, however, while many tax subsidies receive review when major tax cut legislation is being considered or as a result of scheduled expiration dates.

With the growth in recent years in entitlement programs and programs with long-term contractual obligations, a steadily declining share of federal spending is subject to the annual appropriations process. In fiscal year 1982, only about 50 percent of federal spending will be subject to discretionary annual appropriations, compared to 56 percent ten years ago. Even those programs that are subject to annual appropriations may not receive detailed scrutiny every year, since the usual issue is whether a program should get a little bit more or a little bit less, not whether it

5. Congressional Budget Office, Tax-Exempt Bonds for Single-Family Housing (April 1979).
6. Congressional Budget Office, Small Issue Industrial Revenue Bonds, (April 1981).

should exist at all. The same is true of spending programs that must be reauthorized every two or three years. Reauthorization requirements do not guarantee full-scale reexamination of programs and the need for them.

Five major tax cut bills were passed by the Congress in 1969, 1971, 1975, 1976, and 1978. Each provided the occasion for a review of existing tax subsidies, and four of them--the bills passed in 1969, 1975, 1976, and 1978--cut back or eliminated some significant tax subsidies. Each bill also created a number of new tax subsidies. Significantly, however, many of these new subsidies had scheduled expiration dates in order to give the Congress the opportunity to evaluate them after a few years of experience. Many also required that studies of the effectiveness of the new provisions be submitted to the Congress in advance of the expiration dates. Table 4 contains a listing of tax subsidies enacted since 1969 that included expiration dates and/or study requirements.

Setting an expiration date and requiring a study does not, of course, guarantee that the tax subsidy will be carefully reviewed before it is reauthorized, any more than similar requirements guarantee careful review of spending programs. But it does suggest that tax subsidies may become more like direct spending programs in the degree of periodic review that they receive.

#### Administration

Eligibility Rules. The ease of administration of any subsidy program depends mainly on the eligibility rules and how they are enforced. If eligibility depends on a few clear and simple rules, if the information needed to verify eligibility is readily available, and if no significant exercise of judgment is required to apply the rules, administration is relatively easy. But as the eligibility rules become more detailed and complicated, as the information needed to verify eligibility becomes harder to get, and as more individualized judgments become necessary, subsidies become more and more difficult to administer.

Administration of Tax Subsidies. Tax subsidies are not different from other subsidies in this respect. Tax subsidies do have some possible administrative advantages, however. First, a well-run bureaucracy to administer the subsidy already exists--the Internal Revenue Service. The IRS deals on an annual basis with nearly 100 million taxpayers. It has information on where they live, what their income is, how many dependents they have, whether

TABLE 4. NEW TAX EXPENDITURES WITH EXPIRATION DATES AND/OR STUDY REQUIREMENTS ENACTED BETWEEN 1969 AND 1981

| New Tax Expenditure                                                                     | Originally Scheduled Expiration Date and/or Study Requirement                                     |
|-----------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------|
| <b>Tax Reform Act of 1969</b>                                                           |                                                                                                   |
| 5-year amortization of low-income rental housing rehabilitation expenses                | December 31, 1974                                                                                 |
| 5-year amortization of pollution control facilities                                     | December 31, 1974                                                                                 |
| 5-year amortization of railroad rolling stock                                           | December 31, 1974                                                                                 |
| 5-year amortization of coal mine safety equipment                                       | December 31, 1974                                                                                 |
| <b>Revenue Act of 1971</b>                                                              |                                                                                                   |
| 5-year amortization of on-the-job training and child care facilities                    | December 31, 1976                                                                                 |
| Domestic International Sales Corporations (DISC)                                        | Annual Treasury Department reports required on "operation and effect" of DISC system of taxation. |
| <b>Tax Reduction Act of 1975</b>                                                        |                                                                                                   |
| Employee Stock Ownership Plan (ESOP) investment tax credit                              | December 31, 1976                                                                                 |
| New home purchase tax credit                                                            | December 31, 1976                                                                                 |
| <b>Tax Reform Act of 1976</b>                                                           |                                                                                                   |
| Deduction for eliminating architectural and transportation barriers for the handicapped | December 31, 1979                                                                                 |
| Tax incentives for historic preservation                                                | June 1981                                                                                         |

(Continued)



TABLE 4. (Continued)

| New Tax Expenditure                                          | Originally Scheduled Expiration<br>Date and/or Study Requirement                                   |
|--------------------------------------------------------------|----------------------------------------------------------------------------------------------------|
| <b>Tax Reform Act of 1976<br/>(continued)</b>                |                                                                                                    |
| Exclusion for group prepaid<br>legal services                | December 31, 1981; Treas-<br>ury and Labor Department<br>study required by Decem-<br>ber 31, 1980. |
| Possessions Corporation<br>Tax Credit                        | Annual Treasury Department<br>reports required on "oper-<br>ation and effect".                     |
| <b>Tax Reduction and Simplifi-<br/>cation Act of 1977</b>    |                                                                                                    |
| New jobs tax credit                                          | December 31, 1978                                                                                  |
| <b>Revenue Act of 1978</b>                                   |                                                                                                    |
| Exclusion for employer<br>educational assistance<br>programs | December 31, 1983                                                                                  |
| Targeted jobs tax credit                                     | December 31, 1981; Treas-<br>ury and Labor Department<br>report required by June<br>30, 1981.      |
| <b>Energy Tax Act of 1978</b>                                |                                                                                                    |
| Home insulation tax credit                                   | December 31, 1985                                                                                  |
| Solar energy tax credit                                      | December 31, 1985                                                                                  |
| Business alternative energy<br>investment tax credits        | December 31, 1982                                                                                  |
| Exclusion for employer-pro-<br>vided transportation          | December 31, 1985                                                                                  |
| Investment credit for<br>commuter vans                       | December 31, 1985                                                                                  |

(Continued)

TABLE 4. (Continued)

| New Tax Expenditure                                                | Originally Scheduled Expiration<br>Date and/or Study Requirement                |
|--------------------------------------------------------------------|---------------------------------------------------------------------------------|
| Crude Oil Windfall Profit<br>Tax Act of 1980                       |                                                                                 |
| Alternative fuel production<br>credit                              | December 31, 2000                                                               |
| Alcohol fuel tax credit                                            | December 31, 1992; annual<br>Energy Department reports<br>required through 1992 |
| Credit for ocean thermal<br>energy conversion equip-<br>ment       | December 31, 1985.                                                              |
| Credit for small-scale hydro-<br>electric facilities               | December 31, 1985                                                               |
| Credit for cogeneration<br>equipment                               | December 31, 1982                                                               |
| Credit for intercity buses                                         | December 31, 1985                                                               |
| Tax-exempt bonds for small-<br>scale hydroelectric facili-<br>ties | December 31, 1985                                                               |
| \$200/400 interest and divi-<br>dend exclusion                     | December 31, 1982                                                               |
| Economic Recovery Tax Act<br>of 1981                               |                                                                                 |
| Charitable contribution<br>deduction for nonitemizers              | December 31, 1986                                                               |
| Tax credit for research and<br>experimentation                     | December 31, 1985                                                               |
| Tax-exempt savings certi-<br>ficates                               | December 31, 1982                                                               |
| Tax-exempt bonds for pur-<br>chase of mass transit<br>equipment    | December 31, 1984                                                               |

SOURCES: Committee reports on each act.

they own a home or a business, and so forth. It has a way of spot-checking eligibility through its system of audits.

If eligibility for the subsidy is fairly broad and is based on information that already appears on tax returns, there can be advantages in providing it through the tax system. The extra personal exemption for the elderly, for example, is easy for the IRS to administer, since eligibility is open to all those over 65 who have enough income to owe some taxes. (If the subsidy was extended to those without tax liability, however, it would probably be easier to provide it through the Social Security system, since the IRS does not have records on most nontaxpayers over 65.)

To take another example, the tax credit for home insulation, however, presents significant administrative problems for the IRS. The eligibility rules are fairly complicated, since only certain kinds of energy conservation expenses are eligible, the home must be the taxpayer's principal residence, it must have been built before April 1977, and so on. The information needed to determine eligibility is not normally available on tax returns. The IRS has no easy way of checking on whether energy-saving items were actually installed, whether they were of the eligible type, whether they cost as much as the taxpayer claimed, and so forth. In theory some of this could be determined on audit, but only 2 percent of returns are audited, and even then auditors are unlikely to climb around in people's attics to see whether the eligible insulation actually has been installed.

Thus, if the Congress wants to keep fairly close check on eligibility for a subsidy program, providing the subsidy through the tax system may not be the best approach. This is especially true if eligibility rests on information not readily available to the IRS, or on judgments it is not skilled in making. Requiring subsidy recipients to submit detailed application forms in advance, with full review by multilayered bureaucracies, can be quite burdensome. But it is the price that must be paid if detailed checking on eligibility is considered necessary.

If, on the other hand, the Congress determined that the costs of eligibility checks of this kind were likely to be greater than any losses from payments to ineligible recipients, the tax system could have significant advantages as a subsidy distribution mechanism. Advance application is not necessary, and there are no time-consuming reviews before the subsidy is granted. The subsidy can

simply be claimed on the tax return, and received either immediately in the form of a reduced tax bill, or shortly thereafter as a refund. If an audit subsequently determined that the subsidy was improperly claimed, it would have to be repaid with interest and perhaps a fine or penalty. Subsidy programs could be operated in this way outside of the tax system, of course, but the Congress has been reluctant to permit this degree of flexibility for programs other than tax subsidies.

Tax Complexity. While it may sometimes appear simpler to have the IRS administer a subsidy program--especially when there is so little checking on eligibility that the program is not really administered--there are costs in terms of increased complexity on tax instructions and tax forms. Even though only a very small percentage of taxpayers may take advantage of a particular subsidy, the instructions and forms used by all taxpayers must contain information on how to obtain the subsidy. Extra lines must be included on all returns and supplementary forms may be necessary. Table 5 lists some of the major tax expenditure subsidies and the percentage of taxpayers using each of them in calendar year 1978, the most recent year for which complete information is available. While each subsidy may look simple for the IRS to administer when considered alone, the multiplication of them can greatly complicate the task of the IRS and add to the compliance burdens of all taxpayers.

A further problem is that the 40 percent of taxpayers who use the short Form 1040A cannot take advantage of most tax expenditures, and the 70 percent who use the standard deduction cannot use tax expenditures that take the form of itemized deductions. Those who want to use tax expenditures must, therefore, use the long Form 1040 and its associated schedules and supplementary forms, thereby making the task of filing their tax returns much more complicated. As more taxpayers shift to these longer and more complex forms, the task of the IRS is also made much more difficult and time-consuming.

The extra burden imposed on the IRS by the expansion of tax subsidies puts more strains on already limited IRS resources. The percentage of returns that is audited has declined substantially in recent years, from 2.6 percent in 1976 to less than 2 percent in 1981. Audits themselves become more difficult and time-consuming as the complexity of returns increases. The slight likelihood that returns will be audited, combined with the possibility that IRS

TABLE 5. TAX RETURNS WITH SELECTED TAX EXPENDITURES, AS A PERCENTAGE OF TOTAL RETURNS FILED, CALENDAR YEAR 1978

| Tax Expenditure                                | Percent of Total Returns<br>With Expenditure |
|------------------------------------------------|----------------------------------------------|
| Charitable Contributions Deduction             | 26.67                                        |
| State and Local Taxes Paid Deduction           | 28.54                                        |
| Home Mortgage Interest Deduction               | 22.09                                        |
| Medical and Dental Expense Deduction           | 19.91                                        |
| Residential Energy Credit                      | 6.51                                         |
| Child Care Credit                              | 3.82                                         |
| Earned Income Credit <sup>a</sup>              | 4.40                                         |
| Credit for the Elderly                         | 0.77                                         |
| Political Contributions Credit                 | 3.97                                         |
| Work Incentive (WIN) Credit                    | 0.006                                        |
| New Jobs Credit                                | 0.84                                         |
| Individual Retirement Account<br>(IRA) Payment | 2.65                                         |
| Self-Employed Retirement (Keogh)<br>Payment    | 0.70                                         |

SOURCE: Statistics of Income, 1978, Individual Income Tax Returns, Department of the Treasury, Internal Revenue Service (March 1981).

a. Includes refundable portion.

auditors may miss questionable items on complex returns, encourages many taxpayers to view the audit system as a lottery in which they



can take chances with little risk. As this perception grows, the essentially voluntary income tax compliance system may start to break down. Signs of this can already be seen in reports of growing tax avoidance in the so-called "underground economy."

Not all of this increased complexity and extra IRS burden is caused by tax expenditures, of course. Furthermore, there are administrative costs associated with subsidy programs no matter which agency administers them. While the burden on the IRS is a substantial one, the costs of having a particular program administered by some other agency might be even greater.

Divergent Agency Goals. Another consideration in having the IRS administer a subsidy program is that the IRS is not likely to be as sympathetic to the goals of the program as an agency with jurisdiction over analogous direct spending programs might be. Those who work at the IRS consider their main job to be collecting taxes, as fairly and efficiently as they can. They do not view it as their responsibility to solve the nation's housing problems, provide jobs for the hard-core unemployed, preserve historic buildings, encourage the insulation of homes, or stimulate local economic development. Yet tax subsidies have these goals, and many more.

When the IRS is assigned the task of administering subsidy programs of this kind, its response usually is to treat the subsidy as if it were a normal tax provision rather than a subsidy program. The regulations governing eligibility tend to use rules and concepts familiar to tax administrators, whether or not they are appropriate for a subsidy program. Eligibility is restricted as narrowly as possible, consistent with the provisions of the statute, in order to limit opportunities for tax avoidance and to minimize the loss of revenue. Little attempt is made to publicize the availability of the subsidy or to promote its use.

The Congress sometimes seeks to circumvent these difficulties by requiring that administrative responsibility be shared with the agency that administers comparable spending programs. The Labor Department, for example, shares responsibility for administering the targeted jobs tax credit, while the Interior Department shares responsibility for the tax incentives for historic preservation. This may relieve the IRS of making determinations of eligibility in areas where it has little experience or expertise, but the IRS' limited sympathy with subsidy program goals is likely to remain, leading to interagency conflicts over eligibility rules and administrative procedures.

### Beneficiary Perceptions and Preferences

The beneficiaries of a tax subsidy frequently prefer not to think of the tax savings they receive as a subsidy, or as something that is analogous to a federal grant or loan. They choose to view these tax benefits as normal features of the tax code, or as incentives for doing things society considers valuable.

The more tax subsidies are treated like spending programs for budgetary and administrative purposes, the harder it becomes to preserve the perception of tax subsidies that beneficiaries tend to prefer—that is, that they are not really receiving a subsidy. In most cases, the Congress may decide that it is not necessary to defer to this kind of fastidiousness—especially when it stands in the way of goals of budgetary visibility and control—but there may be occasions in which some acknowledgement of this concern is appropriate.

If there is likely to be substantial reluctance to use the subsidy, for example, there may be some justification for making it as easy and comfortable to use as possible. The targeted jobs tax credit is an illustration. It provides employers with a tax credit equal to a portion of the wages they pay to workers who fall into various categories of the hard-core unemployed. Many employers are very reluctant to hire such workers, even with the tax credit. Administrative difficulties and negative perceptions of the subsidy mechanism on the part of employers could increase this reluctance. Providing the subsidy through the tax code might lessen this possibility.

It is not always necessary, of course, to reconcile and standardize everyone's perception of what is going on. It may be possible to provide tax subsidies in ways that permit the beneficiaries to perceive them in the way they find congenial, while still providing the Congress with the information and incentives needed for budgetary review and control. Targeted jobs tax credits, for example, could continue to be provided through the tax code, but the budgetary cost could be charged to the Department of Labor and to the Congressional committees with jurisdiction over analogous spending programs. The Rashomon effect—differing perceptions of the same phenomenon by different people—has its uses in government as well as in literature and drama.

Predictability and Stability. Beneficiaries may also prefer receiving subsidies through the tax code because they may believe

the amount of the subsidy and the manner in which it is provided will be less subject to change than would be the case with a spending program that is subject to annual appropriations and periodic reauthorizations. In general, it is true that tax subsidies are less subject to changes, cutbacks, and delays in funding than federal spending programs, although, as discussed earlier, this treatment of tax subsidies may be changing. Certainly those benefiting in recent years from various tax shelter and tax-exempt bond subsidies have not been immune from unpredictability, since both the Congress and the IRS have continually changed and tightened the rules that apply to these subsidies. Furthermore, the desire of beneficiaries for predictability and stability must always be traded off against the Congress' need to maintain control over the federal budget. Both are important goals, and they must be carefully balanced in evaluating any subsidy program.

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#### CHAPTER IV. TAX EXPENDITURE CHANGES ENACTED IN CALENDAR YEARS 1980 AND 1981

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Significant tax expenditure changes were enacted in both calendar years 1980 and 1981. The changes legislated in 1980 are reflected in the five-year projections of tax expenditures for fiscal years 1981-1986 in Appendix Table A-1, but those enacted in 1981 are not.

##### CALENDAR YEAR 1980 CHANGES

As shown in Table 6, the major 1980 changes were in the Crude Oil Windfall Profit Tax Act and the Omnibus Reconciliation Act. The Windfall Profit Tax Act included business energy investment tax credits, alternative fuel production credits, special provisions for alcohol fuels, tax-exempt industrial development bond financing for energy projects, and residential energy tax credits for homeowners and landlords. It also expanded the existing dividend exclusion to include certain kinds of interest, and doubled the limit on the amount that could be excluded to \$200 (\$400 for joint returns). Finally, the act repealed the "carryover basis" rule that would have required the heirs of inherited property to pay a capital gains tax on otherwise untaxed gains occurring before the inheritance.

The Omnibus Reconciliation Act substantially cut back the use of tax-exempt bonds to finance housing. The act bans further issues of mortgage subsidy bonds after 1983, resulting in a reduction in tax expenditures estimated at more than \$10 billion in fiscal year 1985.

##### CALENDAR YEAR 1981 CHANGES

The only legislation affecting tax expenditures to date in 1981 is the Economic Recovery Tax Act of 1981. As shown in Table 7, the act makes extensive changes in tax expenditure legislation, including eight new tax expenditures, 21 provisions expanding existing tax expenditures, and two provisions reducing tax expenditures. In addition, since the revenue loss from tax expenditures

TABLE 6. REVENUE EFFECTS OF CHANGES IN TAX EXPENDITURES IN CALENDAR YEAR 1980 FOR FISCAL YEARS 1981-1985 (In millions of dollars)

| Change                                                                                      | 1981 | 1982 | 1983 | 1984 | 1985 |
|---------------------------------------------------------------------------------------------|------|------|------|------|------|
| <hr/>                                                                                       |      |      |      |      |      |
| The Crude Oil Windfall Profit<br>Tax Act of 1980 (P.L. 96-223)                              |      |      |      |      |      |
| Business energy investment<br>credits                                                       |      |      |      |      |      |
| Solar and wind property,<br>including solar process<br>heat equipment, 15%<br>energy credit | -15  | -26  | -67  | -185 | -377 |
| Geothermal equipment, 15%<br>energy credit                                                  | -2   | -2   | -3   | -7   | -9   |
| Ocean thermal energy con-<br>version equipment, 15%<br>energy credit                        | a    | a    | a    | -1   | -2   |
| Small-scale hydroelectric<br>facilities, 11% energy<br>credit                               | -11  | -15  | -19  | -48  | -109 |
| Cogeneration equipment,<br>10% energy credit                                                | -46  | -64  | -80  | -74  | -52  |
| Petroleum coke and pitch,<br>regular investment<br>credit and accelerated<br>depreciation   | -31  | -32  | -36  | -40  | -44  |
| Certain equipment for<br>producing feed stocks                                              | ---  | b    | -7   | -28  | -29  |
| Alumina electrolytic<br>cells, 10% energy<br>credit                                         | -1   | -1   | -1   | -1   | -1   |
| Coke ovens, 10% energy<br>credit                                                            | -47  | -51  | -57  | -53  | -35  |
| Biomass equipment, 10%<br>energy credit                                                     | -2   | -4   | -10  | -82  | -246 |
| Intercity buses, 10%<br>energy credit                                                       | -5   | -6   | -6   | -6   | -7   |

(Continued)



TABLE 6. (Continued)

| Change                                                                                 | 1981 | 1982 | 1983 | 1984 | 1985   |
|----------------------------------------------------------------------------------------|------|------|------|------|--------|
| <b>The Crude Oil Windfall Profit<br/>Tax Act of 1980 (P.L. 96-223)<br/>(continued)</b> |      |      |      |      |        |
| Affirmative commitments,<br>special transition rule                                    | ---  | b    | -202 | -407 | -288   |
| Total energy<br>investment credits                                                     | -160 | -201 | -488 | -932 | -1,199 |
| <b>Alternative fuel production<br/>credits</b>                                         |      |      |      |      |        |
| Devonian shale gas,<br>special rule                                                    | -18  | -34  | -25  | ---  | ---    |
| Qualifying processed<br>wood, phase-out<br>suspension                                  | -7   | -18  | -23  | -15  | -5     |
| Steam from agricultural<br>by-products, phase-out<br>suspension                        | -1   | -2   | -2   | -3   | -3     |
| Total, production<br>credits                                                           | -26  | -54  | -50  | -18  | -8     |
| <b>Alcohol fuels<br/>provisions</b>                                                    |      |      |      |      |        |
|                                                                                        | -4   | -4   | -6   | -8   | -187   |
| <b>Industrial development<br/>bonds</b>                                                |      |      |      |      |        |
| Solid waste disposal<br>facilities                                                     | -1   | -4   | -5   | -5   | -5     |
| Alcohol from solid<br>waste facilities                                                 | ---  | a    | a    | a    | -1     |
| Small-scale hydro-<br>electric facilities                                              | a    | a    | -2   | -3   | -5     |
| Additions to certain<br>existing hydro-<br>electric facilities                         | ---  | -1   | -5   | -7   | -8     |

(Continued)

TABLE 6. (Continued)

| Change                                                                                             | 1981 | 1982   | 1983   | 1984 | 1985 |
|----------------------------------------------------------------------------------------------------|------|--------|--------|------|------|
| Industrial development bonds (continued)                                                           |      |        |        |      |      |
| State renewable resource programs                                                                  | -1   | -1     | -3     | -5   | -7   |
| Total bonds                                                                                        | -2   | -6     | -15    | -20  | -26  |
| Residential energy tax credits                                                                     |      |        |        |      |      |
| Solar, wind, and geothermal credit, 40%                                                            | -42  | -52    | -67    | -88  | -128 |
| Business energy tax credit to landlords, 15%                                                       | -2   | -3     | -7     | -17  | -20  |
| Total residential tax credits                                                                      | -44  | -55    | -74    | -105 | -148 |
| Interest and dividend exclusion                                                                    | -314 | -2,278 | -1,713 | ---  | ---  |
| Repeal carryover basis                                                                             | a    | -36    | -95    | -163 | -238 |
| Miscellaneous Revenue Act of 1980 (P.L. 96-605)                                                    |      |        |        |      |      |
| Amortization of business start-up costs                                                            | -22  | -73    | -121   | -180 | -254 |
| Charitable deduction for certain contributions of real property for conservation purposes          | -5   | -5     | -5     | -5   | -5   |
| Investment tax credit for rehabilitated building leased to tax-exempt organizations or governments | -28  | -32    | -38    | -44  | -49  |

(Continued)

TABLE 6. (Continued)

| Change                                                                                                                                     | 1981 | 1982   | 1983   | 1984   | 1985    |
|--------------------------------------------------------------------------------------------------------------------------------------------|------|--------|--------|--------|---------|
| Miscellaneous Revenue Act of 1980 (P.L. 96-605)(continued)                                                                                 |      |        |        |        |         |
| Prevention of abuse of certain employee benefit requirements                                                                               | +50  | +75    | +100   | +100   | +100    |
| Retirement savings by tax credit employee stock ownership plan participants                                                                | -3   | -3     | -3     | -3     | -3      |
| Cafeteria plans permitted to provide deferred compensation under rules applicable to cash or deferred profit-sharing and stock bonus plans | -3   | -3     | -3     | -3     | -3      |
| Extension of time to amend government instruments of charitable split-interest trusts                                                      | -8   | -8     | ---    | ---    | ---     |
| Total miscellaneous                                                                                                                        | -19  | -49    | -70    | -135   | -214    |
| Omnibus Reconciliation Act of 1980 (P.L. 96-449)                                                                                           |      |        |        |        |         |
| Tax on gain on foreigners' real estate investments                                                                                         | +42  | +92    | +102   | +111   | +123    |
| Mortgage Subsidy Bond Tax Act of 1980                                                                                                      | +256 | +1,305 | +3,330 | +6,320 | +10,242 |
| Total Omnibus Act                                                                                                                          | +298 | +1,397 | +3,432 | +6,431 | +10,365 |
| Disclosure of Mailing Addresses (P.L. 96-603)                                                                                              |      |        |        |        |         |
| Investment tax credit offset of alternative minimum tax                                                                                    | -99  | -72    | -57    | -39    | -22     |

(Continued)

TABLE 6. (Continued)

| Change                                                                             | 1981 | 1982 | 1983 | 1984 | 1985 |
|------------------------------------------------------------------------------------|------|------|------|------|------|
| Net Operating Loss                                                                 |      |      |      |      |      |
| Deduction (P.L. 96-555)                                                            |      |      |      |      |      |
| Tax treatment of employees<br>of charities working<br>abroad                       | -40  | -18  | -19  | -21  | -22  |
| Miscellaneous Tax                                                                  |      |      |      |      |      |
| Revisions (P.L. 96-608)                                                            |      |      |      |      |      |
| Special rule for certain<br>distributions from money<br>purchase pension plans     | -3   | -3   | -3   | -3   | -3   |
| Elimination of the Duty<br>On Hardwood Veneers<br>(P.L. 96-541)                    |      |      |      |      |      |
| Extension of provisions<br>relating to historic<br>preservation                    | -2   | -21  | -66  | -111 | -131 |
| 60-month amortization<br>for expenditures to<br>rehabilitate low-income<br>housing | ---  | -1   | -8   | -18  | -26  |
| Certain federal scholar-<br>ship grants and National<br>Research Service Awards    | -4   | -16  | -22  | -23  | -24  |
| Deductions for contribu-<br>tions for conservation<br>purposes                     | -5   | -5   | -5   | -5   | -5   |
| Total hardwood veneers                                                             | -11  | -43  | -101 | -157 | -186 |

(Continued)

TABLE 6. (Continued)

| Change                                                                                 | 1981 | 1982 | 1983 | 1984 | 1985 |
|----------------------------------------------------------------------------------------|------|------|------|------|------|
| Recreational Boating Safety<br>and Facilities Improvement<br>Act of 1980 (P.L. 96-451) |      |      |      |      |      |
| Investment credit and<br>7-year amortization<br>for reforestation<br>expenditures      | -6   | -5   | -7   | -8   | -10  |

SOURCES: Committee Reports and Staff of the Joint Committee on Taxation.

NOTE: A plus sign (+) means a revenue gain and a reduction in tax expenditures; a minus (-) sign means a revenue loss and an increase in tax expenditures.

a. Less than \$1 million.

b. Less than \$5 million.



TABLE 7. REVENUE EFFECTS OF CHANGES IN TAX EXPENDITURES IN THE ECONOMIC RECOVERY TAX ACT OF 1981, FISCAL YEARS 1981-1986 (In millions of dollars)

| Change                                                            | 1981 | 1982 | 1983   | 1984   | 1985    | 1986    |
|-------------------------------------------------------------------|------|------|--------|--------|---------|---------|
| <u>New Tax Expenditures</u>                                       |      |      |        |        |         |         |
| Deduction for Two-Earner Married Couples                          | ---  | -419 | -4,418 | -9,090 | -10,973 | -12,624 |
| Credit for Increasing Research Activities                         | ---  | -448 | -708   | -858   | -847    | -485    |
| Charitable Contributions of Scientific Property Used for Research | a    | a    | a      | a      | a       | a       |
| Motor Carrier Operating Rights                                    | -21  | -121 | -71    | -71    | -54     | -18     |
| Exclusion of Interest On Certain Savings Certificates             | ---  | -398 | -1,791 | -1,142 | ---     | ---     |
| 15% Net Interest Deduction                                        | ---  | ---  | ---    | ---    | -1,124  | -3,126  |
| Reinvestment of Dividends in Public Utility Stock                 | ---  | -130 | -365   | -416   | -449    | -278    |
| Deduction for Certain Adoption Expenses                           | ---  | -9   | -9     | -10    | -11     | -12     |
| <u>Increases in Tax Expenditures</u>                              |      |      |        |        |         |         |
| Child and Dependent Care Credit                                   | ---  | -19  | -191   | -237   | -296    | -356    |
| Charitable Contributions Deduction for Non-Itemizers              | ---  | -26  | -189   | -219   | -681    | -2,696  |
| Rollover Period for Sale of Residence                             | b    | c    | c      | c      | c       | c       |
| Increased Exclusion on Sale of Residence                          | b    | -18  | -53    | -63    | -76     | -91     |
| Changes in Taxation of Foreign Earned Income                      | ---  | -299 | -544   | -563   | -618    | -696    |
| Corporate Rate Reductions                                         | ---  | -116 | -365   | -521   | -565    | -610    |
| Credit for Rehabilitation Expenditures                            | -9   | -129 | -208   | -239   | -302    | -409    |
| Credit for Used Property                                          | -24  | -61  | -74    | -85    | -137    | -198    |
| Charitable Contributions of Scientific Property Used for Research | a    | a    | a      | a      | a       | a       |

(Continued)

TABLE 7. (Continued)

| Change                                                                       | 1981 | 1982 | 1983   | 1984   | 1985   | 1986   |
|------------------------------------------------------------------------------|------|------|--------|--------|--------|--------|
| <u>Increases in Tax Expenditures (continued)</u>                             |      |      |        |        |        |        |
| Commercial Bank Bad Debt Deduction                                           | ---  | -15  | -15    | ---    | ---    | ---    |
| Extension and Modification of Targeted Jobs Tax Credit                       | ---  | -63  | -13    | +57    | +117   | +161   |
| Incentive Stock Options                                                      | a    | a    | a      | a      | +11    | +21    |
| Individual Retirement Savings                                                | ---  | -229 | -1,339 | -1,849 | -2,325 | -2,582 |
| Self-Employed Plans                                                          | ---  | -56  | -157   | -173   | -183   | -201   |
| Employee Stock Ownership Plans                                               | ---  | a    | -61    | -628   | -1,659 | -2,188 |
| Group Legal Service Plans                                                    | ---  | -16  | -24    | -26    | -8     | ---    |
| Tax-exempt Bonds for Volunteer Fire Departments                              | ---  | d    | d      | d      | d      | d      |
| Charitable Contributions by Corporations                                     | ---  | -44  | -93    | -102   | -112   | -123   |
| Amortization of Construction Period Interest and Taxes                       | ---  | -14  | -33    | -27    | -23    | -21    |
| Amortization of Low-Income Housing Rehabilitation Expenditures               | -1   | -8   | -16    | -25    | -35    | -39    |
| Industrial Development Bonds for Mass Transit                                | ---  | d    | -7     | -29    | -54    | -64    |
| <u>Reductions in Tax Expenditures</u>                                        |      |      |        |        |        |        |
| Repeal of \$200 Exclusion of Interest and Return to \$100 Dividend Exclusion | ---  | +566 | +1,916 | ---    | ---    | ---    |
| Tax Straddles                                                                | +37  | +623 | +327   | +273   | +249   | +229   |

SOURCE: Summary of H.R. 4242, the Economic Recovery Tax Act of 1981, prepared by the Staff of the Joint Committee on Taxation (August 5, 1981)

- a. Less than \$5 million.
- b. Negligible
- c. Less than \$10 million.
- d. Less than \$1 million.

that take the form of exemptions, exclusions, and deductions is measured by multiplying the amount excluded by the appropriate marginal income tax rate, the reduction in individual income tax rates scheduled for 1981 to 1985 will reduce the revenue loss from those forms of tax expenditures. There is an offsetting effect for tax expenditures that take the form of itemized deductions, however. The zero bracket amount or standard deduction which absorbs some of the revenue loss that would otherwise be assigned to itemized deductions, is not scheduled to be increased until indexing of the individual income tax starts in 1985. The erosion of the real value of the zero bracket amount by inflation between now and 1985 will add to the measured revenue loss from itemized deduction tax expenditures.

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**APPENDIXES**

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**APPENDIX A**

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TABLE A-1. TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION, FISCAL YEARS 1981-1986 (In millions of dollars)<sup>a</sup>

| Function and Subfunction                                               | Corporations |       |       |       |       |       | Individuals |       |       |       |       |       |
|------------------------------------------------------------------------|--------------|-------|-------|-------|-------|-------|-------------|-------|-------|-------|-------|-------|
|                                                                        | 1981         | 1982  | 1983  | 1984  | 1985  | 1986  | 1981        | 1982  | 1983  | 1984  | 1985  | 1986  |
| 050 NATIONAL DEFENSE                                                   |              |       |       |       |       |       |             |       |       |       |       |       |
| 051 Department of Defense -                                            |              |       |       |       |       |       |             |       |       |       |       |       |
| Military                                                               |              |       |       |       |       |       |             |       |       |       |       |       |
| Exclusion of benefits and allowances to Armed Forces personnel         | ---          | ---   | ---   | ---   | ---   | ---   | 1,585       | 1,715 | 1,850 | 2,000 | 2,160 | 2,335 |
| Exclusion of military disability pensions                              | ---          | ---   | ---   | ---   | ---   | ---   | 170         | 200   | 245   | 285   | 325   | 370   |
| 150 INTERNATIONAL AFFAIRS                                              |              |       |       |       |       |       |             |       |       |       |       |       |
| 155 International Finance                                              |              |       |       |       |       |       |             |       |       |       |       |       |
| Program                                                                |              |       |       |       |       |       |             |       |       |       |       |       |
| Exclusion of income earned abroad by United States citizens            | ---          | ---   | ---   | ---   | ---   | ---   | 640         | 665   | 720   | 775   | 840   | 905   |
| Deferral of income of domestic international sales corporations (DISC) | 1,600        | 1,630 | 1,730 | 1,810 | 1,870 | 1,930 | ---         | ---   | ---   | ---   | ---   | ---   |
| Deferral of income of controlled foreign corporations                  | 480          | 520   | 560   | 605   | 650   | 705   | ---         | ---   | ---   | ---   | ---   | ---   |
| 250 GENERAL SCIENCE, SPACE, AND TECHNOLOGY                             |              |       |       |       |       |       |             |       |       |       |       |       |
| 251 General Science and Basic Research                                 |              |       |       |       |       |       |             |       |       |       |       |       |
| Expensing of research and development expenditures                     | 1,990        | 2,235 | 2,500 | 2,790 | 3,110 | 3,455 | 40          | 45    | 50    | 55    | 60    | 70    |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                                                                          | Corporations |       |       |       |       |       | Individuals |       |       |       |       |       |
|-------------------------------------------------------------------------------------------------------------------|--------------|-------|-------|-------|-------|-------|-------------|-------|-------|-------|-------|-------|
|                                                                                                                   | 1981         | 1982  | 1983  | 1984  | 1985  | 1986  | 1981        | 1982  | 1983  | 1984  | 1985  | 1986  |
| 270 ENERGY                                                                                                        |              |       |       |       |       |       |             |       |       |       |       |       |
| 271 Energy Supply                                                                                                 |              |       |       |       |       |       |             |       |       |       |       |       |
| Expensing of exploration and development costs                                                                    |              |       |       |       |       |       |             |       |       |       |       |       |
| Oil and gas                                                                                                       | 1,875        | 1,915 | 2,220 | 2,580 | 2,870 | 3,090 | 860         | 1,030 | 1,240 | 1,495 | 1,765 | 2,030 |
| Other fuels                                                                                                       | 25           | 25    | 30    | 30    | 35    | 35    | ---         | ---   | ---   | ---   | ---   | ---   |
| Excess of percentage over cost depletion                                                                          |              |       |       |       |       |       |             |       |       |       |       |       |
| Oil and gas                                                                                                       | 545          | 535   | 525   | 535   | 675   | 725   | 1,580       | 1,725 | 1,745 | 1,750 | 2,080 | 2,535 |
| Other fuels                                                                                                       | 530          | 540   | 605   | 670   | 735   | 810   | 20          | 25    | 25    | 25    | 30    | 30    |
| Capital gains treatment of royalties on coal                                                                      | 10           | 10    | 15    | 15    | 15    | 20    | 80          | 90    | 105   | 120   | 135   | 150   |
| Alternative fuel production credit                                                                                | 25           | 55    | 50    | 20    | 10    | ---   | ---         | ---   | ---   | ---   | ---   | ---   |
| Alcohol fuel credit                                                                                               | b            | 5     | 5     | 10    | 15    | 20    | b           | 10    | 20    | 30    | 50    | 65    |
| Exclusion of interest on state and local government industrial development bonds for energy production facilities | b            | 5     | 10    | 15    | 20    | 20    | b           | b     | 5     | 5     | 10    | 10    |
| Residential energy credits                                                                                        | ---          | ---   | ---   | ---   | ---   | ---   | 115         | 190   | 275   | 360   | 520   | 650   |
| Supply incentives                                                                                                 |              |       |       |       |       |       |             |       |       |       |       |       |
| Alternative conservation and new technology credits                                                               | 210          | 295   | 600   | 905   | 955   | 735   | 15          | 20    | 45    | 75    | 100   | 85    |
| Supply incentives                                                                                                 |              |       |       |       |       |       |             |       |       |       |       |       |
| 272 Energy Conservation                                                                                           |              |       |       |       |       |       |             |       |       |       |       |       |
| Residential energy credits                                                                                        | ---          | ---   | ---   | ---   | ---   | ---   | 425         | 420   | 420   | 435   | 445   | 385   |
| Conservation incentives                                                                                           |              |       |       |       |       |       |             |       |       |       |       |       |
| Alternative conservation and new technology credits                                                               | 295          | 375   | 320   | 175   | 80    | 25    | ---         | ---   | ---   | ---   | ---   | ---   |
| Conservation incentives                                                                                           |              |       |       |       |       |       |             |       |       |       |       |       |

(Continued)



TABLE A-1. (Continued)

| Function and Subfunction                                                                  | Corporations |      |      |      |      |      | Individuals |      |      |      |      |      |
|-------------------------------------------------------------------------------------------|--------------|------|------|------|------|------|-------------|------|------|------|------|------|
|                                                                                           | 1981         | 1982 | 1983 | 1984 | 1985 | 1986 | 1981        | 1982 | 1983 | 1984 | 1985 | 1986 |
| 272 <u>Energy Conservation</u><br>(continued)                                             |              |      |      |      |      |      |             |      |      |      |      |      |
| Energy credit for intercity buses                                                         | 5            | 5    | 5    | 5    | 5    | 5    | ---         | ---  | ---  | ---  | ---  | ---  |
| 300 <u>NATURAL RESOURCES AND ENVIRONMENT</u>                                              |              |      |      |      |      |      |             |      |      |      |      |      |
| 302 <u>Conservation and Land Management</u>                                               |              |      |      |      |      |      |             |      |      |      |      |      |
| Capital gains treatment of certain timber income                                          | 470          | 535  | 500  | 675  | 760  | 855  | 135         | 150  | 170  | 190  | 215  | 240  |
| Investment credit and seven-year amortization for reforestation expenditures              | b            | b    | b    | b    | b    | b    | 5           | 5    | 5    | 10   | 10   | 10   |
| 303 <u>Recreational Resources</u>                                                         |              |      |      |      |      |      |             |      |      |      |      |      |
| Tax incentives for preservation of historic structures                                    | 25           | 35   | 50   | 60   | 55   | 45   | 40          | 65   | 90   | 110  | 105  | 80   |
| 304 <u>Pollution Control and Abatement</u>                                                |              |      |      |      |      |      |             |      |      |      |      |      |
| Exclusion of interest on state and local government pollution control bonds               | 490          | 500  | 545  | 575  | 595  | 610  | 230         | 255  | 270  | 285  | 300  | 305  |
| Five-year amortization on pollution control facilities                                    | 35           | 65   | 95   | 110  | 115  | 115  | ---         | ---  | ---  | ---  | ---  | ---  |
| Exclusion of payments in aid of construction of water, sewage, gas and electric utilities | 110          | 115  | 115  | 120  | 125  | 130  | ---         | ---  | ---  | ---  | ---  | ---  |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                                     | Corporations |      |      |      |      |      | Individuals |        |        |        |        |        |
|------------------------------------------------------------------------------|--------------|------|------|------|------|------|-------------|--------|--------|--------|--------|--------|
|                                                                              | 1981         | 1982 | 1983 | 1984 | 1985 | 1986 | 1981        | 1982   | 1983   | 1984   | 1985   | 1986   |
| 306 Other Natural Resources                                                  |              |      |      |      |      |      |             |        |        |        |        |        |
| Expensing of exploration and development costs, nonfuel minerals             | 25           | 25   | 30   | 30   | 35   | 35   | b           | b      | b      | b      | b      | b      |
| Excess of percentage over cost depletion, nonfuel materials                  | 399          | 380  | 420  | 450  | 480  | 585  | 15          | 15     | 15     | 20     | 20     | 25     |
| Capital gains treatment of iron ore                                          | 10           | 10   | 10   | 10   | 10   | 10   | 10          | 10     | 10     | 10     | 10     | 10     |
| 350 AGRICULTURE                                                              |              |      |      |      |      |      |             |        |        |        |        |        |
| 351 Farm Income Stabilization                                                |              |      |      |      |      |      |             |        |        |        |        |        |
| Expensing of certain capital outlays                                         | 75           | 80   | 85   | 90   | 95   | 100  | 455         | 485    | 505    | 520    | 540    | 555    |
| Capital gains treatment of certain ordinary income                           | 25           | 25   | 25   | 30   | 30   | 35   | 405         | 425    | 445    | 470    | 490    | 515    |
| Deductibility of patronage dividends and certain other items of cooperatives | 590          | 630  | 670  | 700  | 750  | 810  | -190        | -200   | -210   | -220   | -230   | -245   |
| Exclusion of certain cost-sharing payments                                   | ---          | ---  | ---  | ---  | ---  | ---  | 75          | 80     | 80     | 75     | 80     | 80     |
| 370 COMMERCE AND HOUSING CREDIT                                              |              |      |      |      |      |      |             |        |        |        |        |        |
| 371 Mortgage Credit and Thrift Insurance                                     |              |      |      |      |      |      |             |        |        |        |        |        |
| Excess had debt reserves of financial institutions                           | 340          | 470  | 525  | 620  | 750  | 895  | ---         | ---    | ---    | ---    | ---    | ---    |
| Deductibility of mortgage interest on owner-occupied homes                   | ---          | ---  | ---  | ---  | ---  | ---  | 19,805      | 25,295 | 31,115 | 37,960 | 46,310 | 56,500 |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                                          | Corporations |       |       |       |       |       | Individuals |        |        |        |        |        |
|-----------------------------------------------------------------------------------|--------------|-------|-------|-------|-------|-------|-------------|--------|--------|--------|--------|--------|
|                                                                                   | 1981         | 1982  | 1983  | 1984  | 1985  | 1986  | 1981        | 1982   | 1983   | 1984   | 1985   | 1986   |
| 371 Mortgage Credit and Thrift Insurance (continued)                              |              |       |       |       |       |       |             |        |        |        |        |        |
| Deductibility of property tax on owner-occupied homes                             | ---          | ---   | ---   | ---   | ---   | ---   | 8,915       | 10,705 | 12,740 | 15,160 | 18,040 | 21,465 |
| Exclusion of interest on state and local housing bonds for owner-occupied housing | 470          | 655   | 860   | 990   | 1,000 | 960   | 370         | 565    | 740    | 865    | 890    | 850    |
| Deferral of capital gains on home sales                                           | ---          | ---   | ---   | ---   | ---   | ---   | 1,100       | 1,220  | 1,345  | 1,480  | 1,630  | 1,790  |
| Exclusion of capital gains on home sales for persons age 55 and over              | ---          | ---   | ---   | ---   | ---   | ---   | 590         | 650    | 710    | 785    | 860    | 950    |
| 376 Other Advancement and Regulation of Commerce                                  |              |       |       |       |       |       |             |        |        |        |        |        |
| Dividend and interest exclusion                                                   | ---          | ---   | ---   | ---   | ---   | ---   | 1,325       | 3,170  | 2,340  | 700    | 770    | 850    |
| Exclusion of interest on state and local industrial development bonds             | 1,000        | 1,245 | 1,590 | 1,935 | 2,290 | 2,655 | 230         | 305    | 390    | 475    | 565    | 655    |
| Exemption of credit union income                                                  | 115          | 125   | 140   | 155   | 170   | 190   | ---         | ---    | ---    | ---    | ---    | ---    |
| Exclusion of interest on life insurance savings                                   | ---          | ---   | ---   | ---   | ---   | ---   | 4,080       | 4,770  | 5,570  | 6,500  | 7,585  | 8,845  |
| Deductibility of interest on consumer credit                                      | ---          | ---   | ---   | ---   | ---   | ---   | 5,260       | 6,040  | 7,050  | 7,965  | 9,005  | 10,175 |
| Expensing of construction period interest and taxes                               | 535          | 565   | 600   | 640   | 685   | 725   | 225         | 310    | 315    | 350    | 380    | 415    |
| Excess first-year depreciation                                                    | 50           | 55    | 55    | 60    | 65    | 65    | 145         | 150    | 160    | 170    | 180    | 185    |
| Depreciation on rental housing in excess of straight line                         | 75           | 80    | 85    | 95    | 100   | 110   | 325         | 345    | 370    | 400    | 435    | 470    |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                                           | Corporations |        |        |        |        |        | Individuals |        |        |        |        |        |
|------------------------------------------------------------------------------------|--------------|--------|--------|--------|--------|--------|-------------|--------|--------|--------|--------|--------|
|                                                                                    | 1981         | 1982   | 1983   | 1984   | 1985   | 1986   | 1981        | 1982   | 1983   | 1984   | 1985   | 1986   |
| 376 Other Advancement and Regulation of Commerce (continued)                       |              |        |        |        |        |        |             |        |        |        |        |        |
| Depreciation on buildings (other than rental housing)                              | 140          | 150    | 165    | 185    | 210    | 240    | 125         | 135    | 150    | 165    | 185    | 210    |
| in excess of straight line                                                         | 3,585        | 3,895  | 4,330  | 4,285  | 3,990  | 3,835  | 180         | 215    | 225    | 225    | 210    | 200    |
| Asset depreciation range                                                           | b            | 10     | 10     | 20     | 25     | 30     | 20          | 65     | 105    | 160    | 230    | 285    |
| Amortization of business start-up costs                                            |              |        |        |        |        |        |             |        |        |        |        |        |
| Capital gains other than agriculture, timber, iron ore, and coal                   | 940          | 1,020  | 1,150  | 1,295  | 1,455  | 1,640  | 16,230      | 18,990 | 21,070 | 23,360 | 25,905 | 28,710 |
| Capital gains at death                                                             |              |        |        |        |        |        | 5,085       | 5,440  | 5,820  | 6,225  | 6,660  | 7,130  |
| Reduced rates on the first \$100,000 of corporate income                           | 7,395        | 7,590  | 8,495  | 9,485  | 10,520 | 11,650 |             |        |        |        |        |        |
| Investment credit, other than for ESOP's, rehabilitation of structures, and energy | 16,395       | 17,340 | 19,265 | 21,240 | 23,375 | 25,810 | 3,130       | 3,425  | 3,815  | 4,205  | 4,625  | 5,105  |
| 400 TRANSPORTATION                                                                 |              |        |        |        |        |        |             |        |        |        |        |        |
| 401 Ground Transportation                                                          |              |        |        |        |        |        |             |        |        |        |        |        |
| Five-year amortization on railroad rolling stock                                   | -40          | -40    | -35    | -20    |        |        |             |        |        |        |        |        |
| 403 Water Transportation                                                           |              |        |        |        |        |        |             |        |        |        |        |        |
| Deferral of tax on shipping companies                                              | 75           | 75     | 80     | 90     | 95     | 105    |             |        |        |        |        |        |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                    | Corporations |      |      |      |      |      | Individuals |       |       |       |       |       |
|-------------------------------------------------------------|--------------|------|------|------|------|------|-------------|-------|-------|-------|-------|-------|
|                                                             | 1981         | 1982 | 1983 | 1984 | 1985 | 1986 | 1981        | 1982  | 1983  | 1984  | 1985  | 1986  |
| 450 COMMUNITY AND REGIONAL DEVELOPMENT                      |              |      |      |      |      |      |             |       |       |       |       |       |
| 451 Community Development                                   |              |      |      |      |      |      |             |       |       |       |       |       |
| Five-year amortization for housing rehabilitation           | 10           | 15   | 15   | 15   | 10   | 5    |             | 20    | 20    | 20    | 15    | 5     |
| Investment credit for rehabilitation of structures          | 150          | 175  | 205  | 225  | 245  | 265  | 145         | 160   | 180   | 200   | 215   | 230   |
| 500 EDUCATION, TRAINING, EMPLOYMENT AND SOCIAL SERVICES     |              |      |      |      |      |      |             |       |       |       |       |       |
| 502 Higher Education                                        |              |      |      |      |      |      |             |       |       |       |       |       |
| Exclusion of scholarship and fellowship income              | ---          | ---  | ---  | ---  | ---  | ---  | 410         | 490   | 565   | 655   | 765   | 885   |
| Employer educational assistance                             | ---          | ---  | ---  | ---  | ---  | ---  | 35          | 40    | 45    | 25    | ---   | ---   |
| Exclusion of interest on state and local student loan bonds | 55           | 85   | 115  | 145  | 175  | 200  | 25          | 40    | 55    | 70    | 85    | 100   |
| Parental personal exemption for students age 19 or over     | ---          | ---  | ---  | ---  | ---  | ---  | 1,045       | 1,055 | 1,065 | 1,075 | 1,085 | 1,095 |
| Deductibility of charitable contributions (education)       | 310          | 310  | 340  | 375  | 420  | 465  | 950         | 1,150 | 1,400 | 1,685 | 2,040 | 2,465 |
| 504 Training and Employment Services                        |              |      |      |      |      |      |             |       |       |       |       |       |
| Maximum tax on personal service income                      | ---          | ---  | ---  | ---  | ---  | ---  | 1,655       | 2,105 | 2,640 | 3,270 | 4,085 | 5,110 |
| Credit for child and dependent care expenses                | ---          | ---  | ---  | ---  | ---  | ---  | 1,025       | 1,175 | 1,350 | 1,555 | 1,785 | 2,055 |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                                                                | Corporations |      |      |      |      |      | Individuals |        |        |        |        |        |
|---------------------------------------------------------------------------------------------------------|--------------|------|------|------|------|------|-------------|--------|--------|--------|--------|--------|
|                                                                                                         | 1981         | 1982 | 1983 | 1984 | 1985 | 1986 | 1981        | 1982   | 1983   | 1984   | 1985   | 1986   |
| 504 Training and Employment Services (continued)                                                        |              |      |      |      |      |      |             |        |        |        |        |        |
| Credit for employment of AFDC recipients and public assistance recipients under work incentive programs | 50           | 50   | 55   | 60   | 60   | 65   | 10          | 10     | 10     | 10     | 10     | 10     |
| General jobs credit                                                                                     | 85           | 25   | 15   | 10   | 10   | —    | b           | b      | b      | b      | b      | b      |
| Targeted jobs credit                                                                                    | 225          | 150  | 20   | b    | —    | —    | 50          | 30     | —      | —      | —      | —      |
| 505 Other Labor Services                                                                                |              |      |      |      |      |      |             |        |        |        |        |        |
| Exclusion of employee meals and lodging (other than military)                                           | —            | —    | —    | —    | —    | —    | 380         | 410    | 445    | 485    | 525    | 570    |
| Investment credit for ESOP's                                                                            | 770          | 820  | 895  | 580  | 195  | 115  | —           | —      | —      | —      | —      | —      |
| 506 Social Services                                                                                     |              |      |      |      |      |      |             |        |        |        |        |        |
| Deductibility of charitable contributions, other than education and health                              | 385          | 385  | 380  | 420  | 465  | 520  | 7,135       | 8,630  | 10,445 | 12,635 | 15,290 | 18,500 |
| Exclusion of contributions to prepaid legal services plans                                              | —            | —    | —    | —    | —    | —    | 35          | 10     | —      | —      | —      | —      |
| 550 HEALTH                                                                                              |              |      |      |      |      |      |             |        |        |        |        |        |
| 551 Health Care Services                                                                                |              |      |      |      |      |      |             |        |        |        |        |        |
| Exclusion of employer contributions for medical insurance premiums and medical care                     | —            | —    | —    | —    | —    | —    | 14,165      | 16,610 | 19,485 | 22,855 | 26,810 | 31,445 |
| Deductibility of medical expenses                                                                       | —            | —    | —    | —    | —    | —    | 3,580       | 4,080  | 4,650  | 5,305  | 6,045  | 6,610  |

(Continued)



TABLE A-1. (Continued)

| Function and Subfunction                                      | Corporations |      |      |      |      |      | Individuals |        |        |        |        |        |
|---------------------------------------------------------------|--------------|------|------|------|------|------|-------------|--------|--------|--------|--------|--------|
|                                                               | 1981         | 1982 | 1983 | 1984 | 1985 | 1986 | 1981        | 1982   | 1983   | 1984   | 1985   | 1986   |
| 551 Health Care Services<br>(Continued)                       |              |      |      |      |      |      |             |        |        |        |        |        |
| Exclusion of interest on<br>state and local hospital<br>bonds | 395          | 450  | 525  | 590  | 655  | 715  | 185         | 220    | 260    | 290    | 325    | 355    |
| Deductibility of charitable<br>contributions (health)         | 195          | 190  | 210  | 235  | 260  | 285  | 1,425       | 1,725  | 1,975  | 2,530  | 3,060  | 3,700  |
| 500 INCOME SECURITY                                           |              |      |      |      |      |      |             |        |        |        |        |        |
| 601 General Retirement and<br>Disability Insurance            |              |      |      |      |      |      |             |        |        |        |        |        |
| Exclusion of Social Security<br>benefits                      | ---          | ---  | ---  | ---  | ---  | ---  | ---         | ---    | ---    | ---    | ---    | ---    |
| Disability insurance<br>benefits                              | ---          | ---  | ---  | ---  | ---  | ---  | 815         | 955    | 1,055  | 1,185  | 1,350  | 1,575  |
| OASI benefits for retired<br>workers                          | ---          | ---  | ---  | ---  | ---  | ---  | 9,020       | 11,265 | 13,260 | 15,605 | 18,320 | 21,435 |
| Benefits for dependents and<br>survivors                      | ---          | ---  | ---  | ---  | ---  | ---  | 1,250       | 1,480  | 1,695  | 1,945  | 2,225  | 2,535  |
| Exclusion of railroad<br>retirement system benefits           | ---          | ---  | ---  | ---  | ---  | ---  | 380         | 435    | 500    | 570    | 655    | 750    |
| Exclusion of workmen's compen-<br>sation benefits             | ---          | ---  | ---  | ---  | ---  | ---  | 2,675       | 3,260  | 3,965  | 4,825  | 5,870  | 7,145  |
| Exclusion of special benefits<br>for disabled coal miners     | ---          | ---  | ---  | ---  | ---  | ---  | 100         | 105    | 110    | 120    | 130    | 140    |
| Exclusion of disability pay                                   | ---          | ---  | ---  | ---  | ---  | ---  | 170         | 170    | 170    | 170    | 170    | 170    |
| Net exclusion of pension con-<br>tributions and earnings      | ---          | ---  | ---  | ---  | ---  | ---  | ---         | ---    | ---    | ---    | ---    | ---    |
| Employer plans                                                | ---          | ---  | ---  | ---  | ---  | ---  | 23,605      | 27,905 | 32,930 | 38,855 | 45,850 | 54,100 |
| Plans for self-employed<br>and others                         | ---          | ---  | ---  | ---  | ---  | ---  | 2,105       | 2,305  | 2,525  | 2,770  | 3,040  | 3,345  |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                                  | Corporations |      |      |      |      |      | Individuale |       |       |       |       |       |
|---------------------------------------------------------------------------|--------------|------|------|------|------|------|-------------|-------|-------|-------|-------|-------|
|                                                                           | 1981         | 1982 | 1983 | 1984 | 1985 | 1986 | 1981        | 1982  | 1983  | 1984  | 1985  | 1986  |
| 601 General Retirement and Disability Insurance (continued)               |              |      |      |      |      |      |             |       |       |       |       |       |
| Exclusion of other employee benefits                                      |              |      |      |      |      |      |             |       |       |       |       |       |
| Premiums on group term life insurance                                     |              |      |      |      |      |      |             | 1,855 | 2,055 | 2,275 | 2,520 | 3,090 |
| Premiums on accident and disability insurance                             |              |      |      |      |      |      |             | 100   | 105   | 110   | 120   | 140   |
| Additional exemption for the blind                                        |              |      |      |      |      |      |             | 30    | 30    | 30    | 30    | 30    |
| Additional exemption for the elderly                                      |              |      |      |      |      |      |             | 2,260 | 2,505 | 2,800 | 3,015 | 3,885 |
| Tax credit for the elderly                                                |              |      |      |      |      |      |             | 125   | 120   | 115   | 110   | 100   |
| 603 Unemployment Compensation                                             |              |      |      |      |      |      |             |       |       |       |       |       |
| Exclusion of other employee benefits                                      |              |      |      |      |      |      |             |       |       |       |       |       |
| Income of trusts to finance supplementary unemployment benefits           |              |      |      |      |      |      |             | 20    | 20    | 25    | 30    | 35    |
| Exclusion of untaxed unemployment insurance benefits                      |              |      |      |      |      |      |             | 5,275 | 4,530 | 4,440 | 4,335 | 4,610 |
| 604 Housing Assistance                                                    |              |      |      |      |      |      |             |       |       |       |       |       |
| Exclusion of interest on state and local housing bonds for rental housing | 195          | 240  | 295  | 350  | 410  | 475  | 235         | 315   | 385   | 450   | 530   | 620   |
| 609 Other Income Security                                                 |              |      |      |      |      |      |             |       |       |       |       |       |
| Exclusion of public assistance benefits                                   |              |      |      |      |      |      |             | 465   | 510   | 560   | 665   | 860   |

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                               | Corporations |       |       |       |       |       | Individuals |       |       |       |       |       |
|------------------------------------------------------------------------|--------------|-------|-------|-------|-------|-------|-------------|-------|-------|-------|-------|-------|
|                                                                        | 1981         | 1982  | 1983  | 1984  | 1985  | 1986  | 1981        | 1982  | 1983  | 1984  | 1985  | 1986  |
| 509 Other Income Security<br>(continued)                               |              |       |       |       |       |       |             |       |       |       |       |       |
| Deductibility of casualty<br>and theft losses                          | ---          | ---   | ---   | ---   | ---   | ---   | 715         | 895   | 1,015 | 1,195 | 1,410 | 1,665 |
| Earned income credit                                                   | ---          | ---   | ---   | ---   | ---   | ---   | 635         | 575   | 525   | 475   | 460   | 425   |
| 700 VETERANS' BENEFITS AND SERVICES                                    |              |       |       |       |       |       |             |       |       |       |       |       |
| 701 Income Security for Veterans                                       |              |       |       |       |       |       |             |       |       |       |       |       |
| Exclusion of veterans' dis-<br>ability compensation                    | ---          | ---   | ---   | ---   | ---   | ---   | 1,300       | 1,575 | 1,860 | 2,135 | 2,460 | 2,825 |
| Exclusion of veterans'<br>pensions                                     | ---          | ---   | ---   | ---   | ---   | ---   | 85          | 95    | 105   | 120   | 130   | 145   |
| 702 Veterans' Education, Training<br>and Rehabilitation                |              |       |       |       |       |       |             |       |       |       |       |       |
| Exclusion of GI bill<br>benefits                                       | ---          | ---   | ---   | ---   | ---   | ---   | 180         | 160   | 130   | 110   | 90    | 75    |
| 800 GENERAL GOVERNMENT                                                 |              |       |       |       |       |       |             |       |       |       |       |       |
| 806 Other General Government<br>Credits for political<br>contributions | ---          | ---   | ---   | ---   | ---   | ---   | 100         | 80    | 80    | 80    | 100   | 80    |
| 850 GENERAL PURPOSE FISCAL<br>ASSISTANCE                               |              |       |       |       |       |       |             |       |       |       |       |       |
| 851 General Revenue Sharing                                            |              |       |       |       |       |       |             |       |       |       |       |       |
| Exclusion of interest on<br>general purpose state<br>and local debt    | 4,035        | 4,315 | 4,885 | 5,335 | 5,720 | 6,040 | 1,895       | 2,165 | 2,420 | 2,645 | 2,840 | 3,005 |

(Continued)

(Continued)

TABLE A-1. (Continued)

| Function and Subfunction                                                                               | Corporations |        |        |        |        | Individuals |         |         |         |         |         |         |
|--------------------------------------------------------------------------------------------------------|--------------|--------|--------|--------|--------|-------------|---------|---------|---------|---------|---------|---------|
|                                                                                                        | 1981         | 1982   | 1983   | 1984   | 1985   | 1986        | 1981    | 1982    | 1983    | 1984    | 1985    | 1986    |
| 851 General Revenue Sharing<br>(continued)                                                             |              |        |        |        |        |             |         |         |         |         |         |         |
| Deductibility of non-<br>business state and local<br>taxes (other than on<br>owner-occupied homes)     | ---          | ---    | ---    | ---    | ---    | ---         | 18,405  | 23,060  | 28,060  | 33,670  | 40,405  | 48,485  |
| 852 Other General Purpose<br>Fiscal Assistance                                                         |              |        |        |        |        |             |         |         |         |         |         |         |
| Tax credit for corporations<br>receiving income from doing<br>business in United States<br>possessions | 1,005        | 1,095  | 1,200  | 1,320  | 1,455  | 1,600       | ---     | ---     | ---     | ---     | ---     | ---     |
| 900 INTEREST                                                                                           |              |        |        |        |        |             |         |         |         |         |         |         |
| 901 Interest on the Public Debt                                                                        |              |        |        |        |        |             |         |         |         |         |         |         |
| Deferral of interest on<br>savings bonds                                                               | ---          | ---    | ---    | ---    | ---    | ---         | -75     | 335     | 335     | 335     | 335     | 335     |
| TOTAL                                                                                                  | 48,775       | 52,090 | 58,190 | 63,750 | 68,905 | 74,565      | 179,845 | 214,190 | 248,245 | 286,780 | 334,820 | 390,725 |

SOURCES: Staffs of the Treasury Department and the Congressional Joint Committee on Taxation.

a. All estimates are based on the tax law enacted as of December 31, 1980.

b. Less than \$2.5 million.

c. CBO estimates that this tax expenditure will result in a significantly higher revenue loss than the JCT-Treasury estimate shown above. CBO estimates a loss of \$17.4 billion in 1981, \$20.5 billion in 1982, \$24.1 billion in 1983, \$28.4 billion in 1984, \$33.5 billion in 1985, and \$39.5 billion in 1986.

d. The figures in the table indicate the effect of the earned income credit on receipts. The effect on outlays is: \$1,205 million in 1981, \$1,115 million in 1982, \$1,030 million in 1983, \$955 million in 1984, \$885 million in 1985, and \$815 million in 1986.

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APPENDIX B

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APPENDIX B. TAX EXPENDITURES BY CONGRESSIONAL COMMITTEE WITH  
AUTHORIZING JURISDICTION OVER RELATED DIRECT OUTLAYS

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## Committee

## Tax Expenditure

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House of Representatives


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## Agriculture

Capital gains treatment of certain ordinary income  
Expensing of certain capital outlays  
Deductibility of noncash patronage dividends and certain other items of cooperatives  
Capital gains treatment of certain timber income  
Exclusion of certain cost-sharing payments

## Armed Services

Exclusion of benefits and allowances to Armed Forces personnel  
Exclusion of military disability pensions

Banking, Finance,  
and Urban Affairs

Exclusion of interest on state and local pollution control bonds  
Exemption of credit union income  
Excess bad debt reserves of financial institutions  
Deductibility of mortgage interest on owner-occupied homes  
Deductibility of property tax on owner-occupied homes  
Exclusion of interest on state and local industrial development bonds  
Exclusion of interest on state and local housing bonds  
Deductibility of interest on consumer credit  
Deferral of capital gains on home sales

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(Continued)

## Committee

## Tax Expenditure

Banking, Finance, and  
and Urban Affairs  
(continued)

Capital gains (other than farming,  
timber, iron ore, and coal)  
Depreciation of rental housing in  
excess of straight-line  
Depreciation of buildings (other than  
rental housing) in excess of  
straight-line)  
Investment credit for certain rehabil-  
itated structures  
5-year amortization for housing reha-  
bilitation  
Exclusion of capital gains on home  
sales for persons age 55 and over  
Expensing of construction period  
interest and taxes  
Exclusion of income earned abroad by  
U.S. citizens  
Deferral of income of Domestic Inter-  
national Sales Corporations (DISC)  
Deferral of income of controlled for-  
eign corporations  
Dividend and interest exclusion  
Corporate surtax exemption  
Reduced rates on first \$100,000 of  
corporate income  
Excess first-year depreciation  
Asset Depreciation Range  
Capital gains at death  
Tax incentives for the preservation of  
historic structures  
Investment tax credit  
Deferral of capital gains on homes  
sales  
Deferral of interest on savings bonds

Education and Labor

Exclusion of scholarship and fellow-  
ship income

(Continued)



## Committee

## Tax Expenditure

Education and Labor  
(continued)

Parental personal exemption for children age 19 and over  
 Deductibility for charitable contributions (education)  
 Credit for child and dependent care expenses  
 Employer educational assistance  
 Expensing of removal of architectural and transportation barriers to the handicapped  
 Credit for the employment of AFDC and public assistance recipients under work incentive programs  
 Additional exemption for the elderly  
 Additional exemption for the blind  
 Exclusion for workmen's compensation benefits  
 Exclusion of special benefits for disabled coal miners  
 Net exclusion of pension contributions and earnings  
     Employer plans  
     Plans for self-employed and others  
 Exclusion of other employee benefits  
     Premiums on group term life insurance  
     Premiums on accident and disability insurance  
 Tax credit for the elderly  
 Earned income credit  
 Deductibility of casualty losses  
 Exclusion of employee meals and lodging (other than military)  
 Maximum tax on personal service income  
 Exclusion for contributions to prepaid legal service plans  
 Investment credit for ESOP's

(Continued)

## Committee

## Tax Expenditure

Education and Labor  
(continued)

Deductibility of charitable contributions for other than education and health  
 Exclusion of employer contributions for medical insurance premiums and medical care  
 General jobs credit  
 Targeted jobs credit

## Government Operations

Tax credit for corporations doing business in U.S. possessions  
 Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes)  
 Exclusion of interest payments on state and local industrial development bonds  
 Exclusion of interest on state and local pollution control bonds  
 Exclusion of interest on general purpose state and local debt

## House Administration

Credits for political contributions

Interior and Insular  
Affairs

Tax incentives for preservation of historic structures  
 Capital gains treatment of royalties on coal  
 Capital gains treatment of royalties on iron ore  
 Expensing of exploration and development costs  
 Excess of percentage over cost depletion  
 Alternative fuel production credit  
 Alcohol fuel credit  
 Residential energy credits  
 Alternative, conservation and new technology credits

(Continued)

| Committee                       | Tax Expenditure                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|---------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Foreign Affairs                 | Exclusion of income earned abroad<br>Deferral of income of Domestic International Sales Corporations (DISC)<br>Deferral of income of controlled foreign corporations                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| Interstate and Foreign Commerce | Deferral of income of Domestic International Sales Corporations (DISC)<br>Deferral of income of controlled foreign corporations<br>Dividend and interest exclusion<br>Exclusion of interest payments on state and local industrial development bonds (other than for education and health)<br>5-year amortization for railroad rolling stock<br>Exclusion of sick pay<br>Expensing of removal of architectural and transportation barriers to the handicapped<br>Deductibility of medical expenses<br>Exclusion of employee contributions for medical insurance premiums and medical care<br>Deferral of tax on shipping companies<br>Deferral of interest on savings bonds<br>Exclusion of other employee benefits<br>Premiums on group term life insurance<br>Premiums on accident and disability insurance<br>Tax credit for corporations doing business in U.S. possessions<br>Exclusion of railroad retirement system benefits |

(Continued)

| Committee                                      | Tax Expenditure                                                                                                                                                                                       |
|------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Interstate and Foreign Commerce<br>(continued) | Exclusion of payments in aid of construction in water and sewage utilities<br>Exclusion of interest on state and local pollution control bonds<br>5-year amortization of pollution control facilities |
| Judiciary                                      | Group legal services exclusion                                                                                                                                                                        |
| Merchant Marine and Fisheries                  | Deferral of tax on shipping companies                                                                                                                                                                 |
| Public Works and Transportation                | Deductibility of state gasoline taxes<br>Exclusion of payments in aid of construction of water and sewage utilities<br>Exclusion of interest on state and local industrial development bonds          |
| Science and Technology                         | Expensing of research and development expenditures                                                                                                                                                    |
| Veterans' Affairs                              | Exclusion of veterans' disability compensation<br>Exclusion of veterans' pensions<br>Exclusion of GI Bill benefits                                                                                    |
| Ways and Means                                 | Exclusion of unemployment insurance benefits<br>Exclusion of income of trusts to finance supplementary unemployment benefits<br>Exclusion of public assistance benefits<br>Earned income credit       |

(continued)

## Committee

## Tax Expenditure

Ways and Means  
(continued)

Exclusion of Social Security benefits  
 Disability insurance benefits  
 OASI benefits for retired workers  
 Benefits for dependents and survivors

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SenateAgriculture, Nutrition,  
and Forestry

Capital gains treatment of certain  
 timber income  
 Capital gains treatment of certain  
 ordinary income  
 Expensing of certain capital outlays  
 Deductibility of noncash patronage  
 dividends and certain other items of  
 cooperatives  
 Exclusion of certain cost-sharing  
 payments

## Armed Services

Exclusion of benefits and allowances  
 to Armed Forces personnel  
 Exclusion of military disability pen-  
 sions

Banking, Housing,  
and Urban Affairs

Exclusion of income earned abroad by  
 U.S. citizens  
 Deferral of income of Domestic Inter-  
 national Sales Corporations (DISC)  
 Deferral of income of controlled for-  
 eign corporations  
 Exemption of credit union income  
 Excess bad debt reserves of financial  
 institutions  
 Deductibility of mortgage interest on  
 owner-occupied homes

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(Continued)

## Committee

## Tax Expenditure

Banking, Housing, and  
Urban Affairs  
(continued)

Deductibility of property tax on owner-occupied homes  
Deductibility of interest on consumer credit  
Deferral of capital gains on home sales  
Dividend and interest exclusion  
Reduced rates on first \$100,000 of corporate income  
Investment tax credit for certain rehabilitated structures  
Capital gains (other than farming, timber, iron ore, and coal)  
Capital gains at death  
Depreciation on rental housing in excess of straight-line  
Depreciation on buildings (other than rental housing) in excess of straight-line  
Expensing of construction period interest and taxes  
Excess first-year depreciation  
Asset Depreciation Range  
5-year amortization for housing rehabilitation  
Tax incentives for preservation of historic structures  
Deferral of interest on savings bonds  
Exclusion of interest on general purpose state and local debt  
Exclusion of capital gains on home sales for persons 55 or older  
Exclusion of interest on state and local pollution control bonds  
Exclusion of interest on state and local industrial development bonds

(Continued)



## Committee

## Tax Expenditure

Commerce, Science, and  
Transportation

Expensing of research and development expenditures  
 5-year amortization on railroad rolling stock  
 Deductibility of nonbusiness state gasoline taxes  
 Deferral of tax on shipping companies  
 Tax credit for corporations doing business in U.S. possessions

Energy and Natural  
Resources

Expensing of exploration and development costs  
 Excess of percentage over cost depletion  
 Capital gains treatment of royalties on iron ore  
 Investment credit for certain rehabilitated structures  
 Tax incentives for preservation of historic structures  
 Alternative fuel production credit  
 Alcohol fuel credit  
 Residential energy credits  
 Alternative, conservation and new technology credits

Environment and  
Public Works

Exclusion of interest on state and local government pollution control bonds  
 5-year amortization of pollution control facilities  
 Exclusion of payments in aid of construction of water and sewage facilities  
 Exclusion of interest on state and local industrial development bonds

(Continued)

## Committee

## Tax Expenditure

## Finance

Exclusion of Social Security benefits  
 Disability insurance benefits  
 OASI benefits for retired workers  
 Benefits for dependents and survivors  
 Exclusion of unemployment insurance benefits  
 Exclusion of public assistance benefits  
 Exclusion of interest on general purpose state and local debt  
 Exclusion of interest on state and local pollution control bonds  
 Exclusion of interest on state and local housing bonds

## Foreign Relations

Exclusion of income earned abroad by U.S. citizens  
 Deferral of income of Domestic International Sales Corporations (DISC)

## Governmental Affairs

Exclusion of interest on general purpose state and local debt  
 Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes)  
 Tax credit for corporations doing business in U.S. possessions

## Labor and Human Resources

Exclusion of scholarship and fellowship income  
 Parental personal exemption for students aged 19 and over  
 Deductibility of charitable contributions (education)  
 Credit for child and dependent care expenses

(Continued)

## Committee

## Tax Expenditure

Labor and Human Resources  
(continued)

Expensing of removal of architectural and transportation barriers for the handicapped  
 Credit for employment of AFDC and public assistance recipients under work incentive programs  
 Maximum tax on personal service income  
 Exclusion of employee meals and lodging (other than military)  
 Exclusion of contributions to prepaid legal service plans  
 Investment credit for Employee Stock Ownership Plans (ESOPs)  
 Deductibility of charitable contributions to other than education and health  
 Exclusion of employer contributions for medical insurance premiums and medical care  
 Deductibility of medical expenses  
 Deductibility of charitable contributions (health)  
 Exclusion of railroad retirement system benefits  
 Exclusion of workmen's compensation benefits  
 Exclusion of special benefits for disabled coal miners  
 Net exclusion of pension contributions and earnings  
     Employer plans  
     Plans for self-employed and others  
 Exclusion of other employee benefits  
     Premiums on group term life insurance  
     Premiums on accident and disability insurance

(Continued)

| Committee                                | Tax Expenditure                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Labor and Human Resources<br>(continued) | Exclusion of capital gains on home<br>sales for persons age 55 and over<br>Additional exemption for the elderly<br>Tax credit for the elderly<br>Exclusion of interest on life insurance saving<br>Exclusion of sick pay<br>Exclusion of income of trusts to finance supplementary unemployment benefits<br>Additional exemption for the blind<br>Deductibility of casualty losses<br>General jobs credit<br>Targeted jobs credit<br>Employer educational assistance |
| Judiciary                                | Exclusion of contributions to prepaid legal services plans                                                                                                                                                                                                                                                                                                                                                                                                           |
| Rules and Administration                 | Credits for political contributions                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| Veterans' Affairs                        | Exclusion of veterans' disability compensation<br>Exclusion of veterans' pensions<br>Exclusion of GI bill benefits                                                                                                                                                                                                                                                                                                                                                   |

NOTE: Some tax expenditures are listed under more than one category because of overlapping committee jurisdictions.

Mr. LONG. Our next witness is the Honorable James Jones, chairman of the Budget Committee.

Mr. Jones, we are pleased to have you. Proceed in your own way.

**STATEMENT OF HON. JAMES R. JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA, CHAIRMAN OF THE COMMITTEE ON THE BUDGET**

Mr. JONES. Thank you.

Mr. Chairman, I welcome the opportunity to testify today on H.R. 4882, as proposed by Congressman Bonior, a bill to amend the Budget Act by including tax expenditures in the aggregates—presently revenues, budget authority, outlays, the deficit, and the Federal debt—which are specified as targets or limitations in budget resolutions. This proposal reflects a continuing and justified concern over budgetary control and, more specifically, control over certain activities, whether on or off budget, which have shown especially rapid growth. Recently, in response to similar concerns, the congressional budget process has begun to evolve procedures for dealing with Federal credit activities, and suggestions have also been made that regulatory activities be placed under more systematic control.

The House Budget Committee, which has responsibility for overseeing aggregate budget activity, has a strong interest in proposals to control tax expenditures, just as it has an interest in controlling outlays, Federal credit activities, and off-budget spending. All these activities, in spite of differences among them, require financing which increases Federal participation in the credit markets; in addition, they redirect resources and incomes from certain activities and social groups to others. For both these reasons, these activities are an appropriate concern for national fiscal policy.

There can be little doubt that budget control, to work successfully, must set some effective constraints on each of these different types of Federal activity; to the extent that restraint is focused exclusively or primarily on some of these activities, pressures will increase to expand the others. Indeed, some have indicated that insufficient control over tax expenditures may account for their extraordinarily rapid growth in recent years. I would favor more direct and specific restraints on tax expenditures, as provided in H.R. 4882, if sufficiently accurate, enforceable and generally acceptable procedures and controls could be developed. I believe such a goal is attainable in a three-step, three-stage process which would produce agreed standards of clarification and accounting, provide greater visibility to tax expenditures and corresponding direct outlays, and finally, include the tax expenditure budget as targets in a resolution.

Let me dispose of one red herring at the very outset. One does not have to subscribe to the theory that the Federal Government is entitled to 100 percent of everyone's income to appreciate the value of tax expenditure accounting as a useful analytic tool. Tax expenditures are attempted measurements of the cost of exceptions to or deviations from the normal tax system and what it would collect, which is certainly not 100 percent of income, but a percentage of adjusted income. Nowhere is the base against which meas-



urements are made all income, therefore. Nor does one have to agree with everything that Professor Surrey has to say on the subject of tax expenditure theory. The fact is that no member of the tax-writing committees would agree even to sponsor a tax measure these days without inquiring into its revenue implications, or just how much money the Government would be forgoing. In short, creating new tax incentives or expanding existing ones has a revenue implication and hence a deficit impact just as surely as a direct spending measure.

Having said this, however, I must indicate the extreme importance I place on moving thoughtfully and carefully if the Congress wishes to increase the control it exercises over tax expenditures. There are two perspectives which suggest a need for great care in this area. First, from the perspective of the budget process, we must not subject this gradually evolving system to pressures and strains which overtax its capacity to function effectively—or, indeed, to function at all. We are all aware of the strains which have been placed upon the process this year, and there is room for legitimate debate about whether the system was always used in accord with the spirit, if not the letter, of the Budget Act. This is one of those situations in which the best might be the enemy of the good, if we move hastily.

My second perspective is that of tax policy, in which I have had a longstanding interest as a member of the Committee on Ways and Means. Having been closely involved in tax policy over a number of years and a vast array of tax legislation, I am very aware of some of the special problems which would be involved in extending budgetary control over tax expenditures. Although some of these problems may seem quite arcane, it is essential that we recognize the problems involved before we head down that road, not afterward. Let me discuss several which seem to be most important.

#### WHAT DO WE WISH TO CONTROL?

The discussion of tax expenditures and the budget sometimes leaves the impression that we do not at present control tax expenditures. This, of course, is untrue. Tax expenditures—leaving aside the definitional problem for the moment—are controlled within the aggregate revenue total of the budget in a manner quite analogous to the control of spending. The enforcement of the revenue floor in a second, or subsequent, budget resolution under section 311—the point-of-order provision—provides exactly the same control over revenue reductions, whether through tax expenditure increases or general tax reductions, that it does over spending. Given the overall revenue constraint in a budget resolution, larger tax expenditures can be enacted only if existing ones are repealed or restrained, or if additional revenues are found, or less are forgone, through changes in tax rates or other parts of the so-called normal tax structure.

While tax expenditures and spending are treated similarly with respect to enforcement of the budget aggregates in the second—or subsequent—budget resolution, the treatment is different in other respects. For instance, tax expenditure targets by function are not set in the budget resolutions, as is done for spending, nor do the



functional totals for existing tax expenditures which are displayed in the reports of the Budget Committees receive the prominence or attention given to the functional spending estimates.

Proposals to control tax expenditures therefore, are really proposing a distinction between tax expenditures and other tax reductions, such as reductions in tax rates or increases, say, in the personal exemption. Such a distinction rests upon a presumption that tax expenditures are unlike, general tax reductions and, perhaps, more like ordinary spending. Specific control of tax expenditures implies that they should not compete for fiscal resources solely or even primarily with general tax expenditures but should be subject to a separate constraint, presumably to facilitate easier comparison and tradeoffs with spending programs. Undoubtedly in many cases this view is appropriate, but I doubt that agreement would be found in all cases. For instance, although the recently enacted reduction of the marriage penalty through a deduction of a portion of second earner income fits the technical description of a tax expenditure quite closely, it is certainly not obvious that this provision resembles spending programs more closely than it does general tax reductions. Had a different approach to the problem been taken, such as allowing optional individual filing, it would have been very difficult to fit it into the tax expenditure rubric at all. This leads me to the sticky question which has been raised previously this morning, of defining tax expenditures.

#### DEFINITIONAL PROBLEMS

Obviously, any control system for tax expenditures would require agreement, not merely on a definition, but upon its application to specific tax provisions. Tax expenditures are defined in the Budget Act as

\* \* \* revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.

As with many definitions, however, when we get down to specific cases we run into problems. While the conceptual reference for defining tax expenditures is a theoretically "pure" income tax structure, in practice this has to be modified substantially to take account of administrative or other concerns, leaving the "normal tax structure" as the operational standard. Normality, however, can be very much in the eye of the beholder.

To take a critical example in which I have a strong interest, consider the recently enacted Accelerated Cost Recovery System [ACRS] the final version of the accelerated depreciation proposal which I coauthored with Congressman Conable. Following the definition, and Treasury and Joint Tax Committee past staff practice, ACRS apparently would give rise to a tax expenditure because it provides for more rapid depreciation than that provided by IRS guidelines. But this just begs the question, because many of us believed that the IRS guidelines were sometimes seriously deficient as estimates of useful lives and, in many cases, quite arbitrary. The problem here is that we don't, in fact, have a widely accepted operational norm against which to measure tax expenditure deviations in the case of depreciation. Without such a norm, it becomes quite

difficult to reach agreement on which provisions, or what proportion of any provision, belongs on our list of tax expenditures and what does not. Current discussions within the administration, if reports are to be believed, illustrate the substantial disagreements which can arise with respect to the definition of tax expenditures.

The list of difficult cases becomes quite lengthy if one begins to examine the conventional list of tax expenditures closely. I won't go down the list, but let me just suggest a couple of other tough cases.

The exclusion from taxable income of 60 percent of capital gains is normally listed as a tax expenditure. Yet, the exclusion reflects to a large extent an attempt at rough justice by offsetting some or all of the taxation of capital principal, rather than income, produced by inflation, and, perhaps as well, to offset the double taxation of corporate dividends. How much, if any, of the exclusion ought to be counted as a tax expenditure will differ with each asset, depending on the holding period and the past rate of inflation. In such a situation, any tax expenditure rule will be arbitrary—and generally incorrect.

Another troublesome case—for slightly different reasons—"consumer interest," the deductibility of which many of us would argue conflicts with our goal of increased savings and investment. It's not too difficult to define this tax expenditure on paper, although even here there are problems. But it's extremely difficult, given the fungibility of capital, to actually design a limitation on this tax expenditure which will have the desired effect. In this case, the definition doesn't fit financial behavior well enough to be operational.

To date, of course, these definitional difficulties have not been a major problem, precisely because definition was not critical to policy as long as tax expenditures and other tax reductions were considered together. Inclusion of a tax provision in the tax expenditure list has been largely informational, and Treasury, Joint Tax Committee, CBO, and Budget Committees staff have usually been able to negotiate or compromise definitional disagreements. However, it would be naive of us to think that very important and real differences could be reconciled so easily if definitions become critical to policy, as would be the case with a specific tax expenditure limitation.

A final definitional and conceptual problem has to do with the scope of tax expenditures with respect to the tax system. At present, tax expenditures are defined solely with respect to the income tax. Recently, with the advent of the windfall profit tax, excise taxes have become an increasingly important part of the tax structure and, in this era of "revenue enhancement," new excise tax proposals have been receiving increased attention. However, little attention has been paid to the concept of a "normal excise tax" structure or a definition of excise tax expenditures to go with it. Presumably a carefully designed policy would need to address this issue.

## MEASUREMENT PROBLEMS

Problems in measuring tax expenditures are perhaps even more arcane than the definitional problems, but we would ignore them at our peril.

First and foremost is the problem that tax expenditures are never observable; they are always an estimate of what "might have been," of the revenues that would have been collected in the absence of the special tax provision in question. In this they differ fundamentally from direct spending. Outlays are also estimates before the fact, and these spending estimates, as has often been pointed out, suffer from many of the same uncertainties as estimates of tax expenditures. But after the fact, when the books on spending are closed, the bean counters at OMB and CBO can count the spending beans; we know that Treasury put out \$660.5 billion of cash in fiscal year 1981. With tax expenditures we can never count the beans—only the might-have-beens. As a result, one cannot readily evaluate and improve upon the estimates. Since these estimates therefore have to be accepted more upon faith than experience, it subjects the process to an extra burden of credibility. Tax expenditure estimates have yet to be tested in the heat of policy differences. It would be prudent to examine them closely before placing undue weight upon them.

One well-known measurement problem I will only discuss briefly here—that the aggregate of tax expenditures cannot easily be constructed or estimated because of the interactions between different tax expenditures and between tax expenditure provisions and the general tax structure. This might not be of great import if a tax expenditure control mechanism were to deal only with increments in tax expenditures, positive or negative, relative to a given base. But some control proposals, including H.R. 4882, would set the level of tax expenditures in a budget resolution, as well as changes in the level. This might, of course, be operational if everyone agreed to say that the emperor was wearing a fine suit of clothes; but it could be quite embarrassing to the process if someone was indecent enough to suggest, correctly, that we really have no good measure of the total of tax expenditures, in the sense that we do for outlays or revenues. Unfortunately, this is not a small matter. The Treasury recently attempted to estimate the value of all tax expenditures which were individual income tax deductions. It estimated that these, taken together, reduced revenues by \$62.3 billion, whereas the simple addition of the individual provisions came to \$81.8 billion.

As a final comment on the measurement complexities one can expect to encounter in dealing with tax expenditures, I simply touch upon the adjustment one must make if tax expenditure dollars are to be compared to direct outlay dollars. Tax expenditures, by their very nature, are after-tax estimates, whereas outlays most often are before tax. Hence they are not strictly comparable, budget dollar for budget dollar, in terms of after-tax value to the intended recipient, a crucial consideration when determining which route to go—direct spending or tax expenditure. Consequently, tax expenditures in these discussions are translated into "outlay equivalent" amounts. The exercise adds one more layer of complexity to



the whole process and the amounts involved are far from trivial, as section G in the Special Analyses of the President's Budget underlines.

#### NEXT STEPS TO BE TAKEN

None of these caveats should be taken to imply that additional and specific control of tax expenditures is infeasible. As a matter of fact, in the last Congress I recommended a study of tax expenditure controls as well as putting a limit on direct spending controls as a percentage of GNP. Given the political will, Congress should eventually be able to develop a set of working rules which could resolve in practice, even if not in concept or theory, the definitional and measurement difficulties. But we should not be misled into thinking that the problems are easy to solve or that agreements will easily be reached.

How then should we proceed? I would suggest a three-step process. First of all, I would like to see the Congress and the administration develop a more precise definition, classification, and accounting system for tax expenditures. We need to determine the areas of agreement and disagreement on issues of definition and measurement, and to settle on procedures for resolving disagreements. This basic problem must be solved before tax expenditures are included in the budget resolution. If it is not solved beforehand, we will only invite criticism of our procedures and accounting measures.

Second, once we have made some progress in dealing with the definition and measurement issues, we should familiarize policymakers and the public with tax expenditures by raising their visibility in the budget process. The tax expenditure budget already required by law could be given more prominence in the budget committees' deliberations and reports. This should induce the display and discussion of tax expenditures by functional categories; perhaps in terms of outlay equivalents, in order to facilitate comparison with direct spending programs and to gage the total commitment of budget resources, both outlays and forgone revenues, to different uses.

Finally, the Congress might consider moving toward a system of tax expenditure control. The first step here might be analogous to the procedures used in the case of the credit budget, in which the Budget Committees and the Congress vote on nonbinding targets for loan programs. Experience with this process, and with the scorekeeping system necessary to make it work, could then lead to binding limitations within the second and subsequent budget resolutions, as provided in H.R. 4882.

#### CONCLUSION

Mr. Chairman, I would like to commend you and the committee and Mr. Bonior for holding these hearings on tax expenditures and other facets of the budget process. I think this is a matter that does need our careful consideration, and I hope that the committee and the Congress will proceed with that careful thought.

Mr. BEILENSON. Mr. Chairman, thank you very much for your testimony.

Mr. JONES. Let me also say I have Mr. John King here from the Budget Committee who specializes more in the tax expenditure area and if we have some technical questions I cannot answer, he would be happy to do that.

Mr. BEILSON. Are we to understand that you support Mr. Bonior's proposal so long as it is done carefully and thoughtfully?

Mr. JONES. Yes. I think bringing tax expenditures into the budget process in a more realistic and open way does help get control over the total budget process, and I support the concept. But I want to caution that as we move on this we ought to do it very carefully, because right now we are practically overloading the budget system given our ability to measure, define, and control, just on the outlay side.

Mr. BEILSON. I understand your concerns. I think you are absolutely correct, and I think it is useful for you to remind us so that we do it carefully and thoughtfully but with some caution. You are supportive of this kind of proposal?

Mr. JONES. I have no objection to trying to measure tax expenditures and ultimately putting some types of controls on them.

Mr. BEILSON. It is all right with you if we go ahead and have some more hearings on it?

Mr. JONES. Certainly. I wish you would also include in your deliberations on needed legislative discipline new limitations on outlays. I feel strongly that we need some more statutory discipline on outlays and credit in our budgets, and I would like to move in that direction.

Mr. BEILSON. That is a useful suggestion too. We would hope to look at the budget process as a whole in the next year or so, and might include some suggestions you have made.

Let me ask you this: You talk at the end of how we should proceed in a three-step fashion. The first thing you bring up, quite properly, is the problem of definition and classification. Do you think we can successfully do that? I am asking that kind of rhetorically, in a way.

There are apparently now about 104 so-called tax expenditures or tax expenditure items in the budget. People seem to know more or less what they are. I assume there is disagreement, perhaps, on some of them, but isn't it true most people agree that most of these 104 can properly be classified as tax expenditures or whatever else we want to call them?

Mr. JONES. As I understand the history of this, this was all part of putting together the Budget Act, the budget process, and there was some agreement on a number of what would be classified as tax expenditures. The attention devoted to these definitions was not that great because this was an informational-type thing, informational as far as the budget is concerned.

I pointed out in my testimony some examples of where the definitions are not that accurate or precise when you start taking apart and examining closely different parts of the Tax Code, and that the definitions need to be upgraded or tightened, particularly since we are departing from a mostly income-based tax system, and are moving toward one which is consumption-based in a number of respects, in which the tax expenditure definitions used in the budget process today are not quite as applicable.

Mr. BEILENSEN. But you have no reason to suggest or think that we couldn't successfully solve most of these definitional problems. We might not agree on all of them but just because it is difficult doesn't mean we can't do it and that we shouldn't arrive at some kind of conclusion.

Mr. JONES. As I say in my testimony: The first step is that we need to try to update the definitions of tax expenditures and agree on a mechanism to resolve the differences of opinion on definition.

No; I am not saying stop it. I am just saying this would be the first step. I think we should proceed.

Mr. BEILENSEN. You don't foresee the three steps taking an inordinate amount of time, do you?

Mr. JONES. I think they should be given such time as necessary to make sure that they are done correctly. I think it would be a mistake—the same argument that I made against the administration's budget earlier this year would apply to this or similar type proposals—to promise more than you can deliver.

Remember this whole process is based to a great extent on faith and accomplishment, and if you're going to put something out there that the system can't accept or work with, then let's just not do it. We have got a lot of laws that are unnecessary and unworkable because we moved too hastily.

Mr. BEILENSEN. It just seems to me those of you who are specifically concerned with controlling the size of the budget would be very strongly supportive of this kind of proposal, providing it can be done properly.

Mr. JONES. I might point out that the Budget Committee staff has been directed by me to look at this and a whole range of other suggestions on ways to increase the discipline of the budget process. We had hoped to be able to present these to the Rules Committee this fall or this winter as part of a package of recommendations to change the Budget Act in a number of respects.

That is not possible because of the rather tumultuous year we have had with the 1982 budget, plus getting ready for 1983. But we are going to continue to study these proposals, and it is my hope that after the 1983 budget is concluded we can make a number of recommendations and this would be one of them.

Mr. BEILENSEN. We would certainly enjoy or appreciate receiving from your committee and staff any suggestions you might have along these lines.

Mr. JONES. We intend to do that.

Mr. BEILENSEN. Clearly there are other areas of the Federal spending that we ought to be looking at if we are really serious about controlling the budget.

Thank you very much.

Mr. LONG. Mr. Latta.

Mr. LATTA. Thank you, Mr. Chairman.

Thank you, Jim, for your testimony. Let me first of all ask you a question. Did you get that unanimous consent?

Mr. JONES. We are waiting for the minority leader to get back so that he can buttress that.

Mr. LATTA. I raised the definition question, I don't think you were here when we first talked about the definition question which



you have also raised. I think this is one of the real problems we face as we go about this.

The thing that I can't quite understand in this is how they arrived at their 10 cent tax expenditures. I assume there are 104 of them—I haven't counted them. Naturally they hesitate to mention as some of them the additional exemptions to the blind. The additional exemption for the elderly in income tax, deductibility of casualty and theft losses, earned income credit, mortgages, and so forth and they don't even list the general personal exemptions under the Income Tax Code.

Do you know why they don't do that?

Mr. JONES. No. Perhaps some of your subsequent witnesses can explain the history of how they came up with this list of definitions.

Mr. LONG. If the gentleman will yield, I have not studied this, but it seems to me, according to the definition which Mr. Beilenson read, the exemption applies absolutely across-the-board to all taxpayers, and would not be within the definition of tax expenditure. That's my recollection.

Mr. LATTA. I want to speak to that point.

Mr. JONES. I think that is right, but I am not sure that even that standard of definition is applied considerably in their definition of tax expenditures.

Mr. LATTA. No; I don't think it possibly could, and it wouldn't be fair to do that. For example, take the wage earner working every day and due to his income determining he can have two or three children and support them without putting them on welfare. And he does that.

Under the tax code, he and his wife and two children will get four exemptions. The individual who doesn't care enough to roll up his sleeve and work as hard may have six or eight kids. He can take \$1,000 exemption for each one of them. I think if you are going to look into this thing, you have got to really look at it and lay it all out on the table as to who is going to do the benefiting and who is not.

Mr. JONES. There are some suggestions that we go to a gross income tax, for example. Under that concept, presumably, you could have a definition that a gross income tax is whatever one owes in an income category to the financing of the Government, and that anything one gets back from the Government in the way of a direct or indirect expenditure, such as by not having to pay taxes because one got an exemption or was blind or whatever, would be classified as a tax expenditure. But I just think that this definitional issue needs to be explored very carefully, particularly in light of the changing nature of the Tax Code.

Mr. LATTA. That is probably one of the reasons for your first suggestion for nonbinding targets initially rather than any kind of a binding target.

Mr. JONES. We are doing this in the credit budget, as you know.

Mr. LATTA. Right. I kind of think there we ought to come very quickly to some kind of a binding situation about credit because you and I know it is out of hand. Just putting some kind of target out there is meaningless.

Mr. JONES. There, again, the same caution that I suggest for tax expenditures we suggested for the credit budget. Let's do it right when we finally make it binding.

Mr. LATTA. One other comment that I would like to make. As you know, we ran into a hailstorm on reconciliation, because all of these committees were saying, we were trespassing on their territory and we shouldn't do that. How would we fare with Ways and Means? Would you comment on that? Wouldn't they again say we were trespassing on their territory?

Mr. JONES. I am sure that the leadership——

Mr. LATTA. I am talking about one committee versus another.

Mr. JONES. I am sure the leadership of the Ways and Means Committee would probably have conversations similar to those the leadership of the Appropriations Committee have had with the Speaker in my presence this year; I am sure I have heard the argument from Jamie Whitten first, and Dan would probably follow along the same lines.

Mr. LATTA. So we might as well get prepared for that if we proceed?

Mr. JONES. Yes.

Mr. LATTA. Thank you very much.

Mr. LONG. Mr. Bonior.

Mr. BONIOR. I don't want to take too much time, Mr. Chairman, because I know we have to vote shortly. But I want to thank Mr. Jones for appearing and for his thoughtful testimony. I think you raise some very important questions that have to be addressed, especially in terms of measurability and definition, and I think your testimony will be extremely helpful.

Last year Dr. Rivlin warned us that with the imposition of binding ceilings on direct expenditures, efforts would be made to establish programs through the regulated route, vis-a-vis tax expenditures, and I am wondering as the chairman of the Budget Committee how would you view that possibility? Do you worry about circumventing the processing, creating a situation which has produced charts like this one, and of course deficits ranging from hundreds of billions of dollars?

Mr. JONES. As chairman of the Budget Committee, and also as a member of Ways and Means, I have to be concerned about that. We hear a lot of slogans that the Government ought to be run more like a business and what have you. Very obviously, if you are running a business it matters not how cost conscious you are, if you do not have any revenues. You still go bankrupt. And so you have to be concerned about the revenue or income side of the picture. When you're dealing with Federal revenues, you also have to be concerned about fairness too, which is something I think we are going to be exploring more, as to whether the sacrifices and rewards of this economic system are evenly distributed.

Mr. BONIOR. I think if you want to examine that further, a good starting point for that would be the CRS study on tax expenditures and who they benefit most. I think I alluded to that in my testimony. I don't know if you were here for that.

Mr. JONES. I didn't hear that.

Mr. BONIOR. I think it quite clearly shows that those people at the top, \$50,000 per year or above, 5.6 percent of the taxpayers are

the prime beneficiaries, although not the only beneficiaries of tax revenues. The regressive nature of them is an interesting issue which ought to be looked at in light of the direct spending.

Mr. JONES. I would look at that study. The corollary to that is that they are also even larger payers of taxes too. I come from a general bias in favor of tax expenditures as being a more efficient distribution mechanism for a public policy program. However, you cannot make that claim across the board, and that is why I think there is some useful purpose in putting some review and controls on tax expenditures. There are some areas in which the direct expenditure is more efficient, although as a general rule I don't agree with that.

Mr. BONIOR. Thank you.

Mr. LONG. Thank you, Mr. Bonior. Mr. Rhodes.

Mr. RHODES. Mr. Chairman, I want to thank you for your very fine statement, and particularly for that part of it dealing with the budget process. Having been one of the daddies of the budget process a long time ago, and one of the members of the committee when it was first put together, I certainly agree with you that it is still fragile, and it has been beset by dragons that we never dreamed were even in existence when we put it together. I think that we have to be very careful that we don't overload it.

I also appreciate the point which you made very ably that this is not a simple matter, and it should not be oversimplified. I imagine you would agree with me when I say that all of these so-called tax expenditures, each of them I suppose has a different genesis, and possibly different motivation.

I am not sure you were here when I was commenting on the testimony of the gentleman from Michigan, but I said at the time that I think that they divide themselves into about three categories. One was in response to an economic motive which the Congress felt was important at the time, another one a social motive possibly, and another one just because somebody or some group had the muscle to get it through. And I think when you look at all 104—I don't know that that is a correct figure but I will take it—104 tax expenditures, you have got to look at each one.

I don't really see any way that you can put together a formula and measure each one of them by that formula. I agree that it is important that there be a study made, to make sure that the motivation of Congress at the time that the tax expenditure was put into being is still relevant or is still extant.

Mr. JONES. Yes.

Mr. RHODES. But nevertheless I am inclined to agree with the gentleman from Ohio. I believe that maybe this hearing, while I congratulate the chairman for having it, would be more properly housed in the Ways and Means Committee or the Budget Committee.

Mr. JONES. I would suggest that at least the Rules Committee should move forward with the same due deliberative speed as they did on the legislation I introduced to limit spending to a percentage of GNP. In that way we will solve them both in the next Congress.

Mr. LONG. Thank you, Mr. Jones.

Mr. JONES. Thank you.



Mr. LONG. The matter pending on the floor is the legislation on the Alaskan Pipeline. The committee will stand in recess for 5 minutes. The witness when we return will be the Honorable Richard Gephardt from Missouri.

[A brief recess was taken.]

Mr. LONG. The committee will come to order.

Mr. Gephardt is under some constraints in respect of time.

Without objection, Mr. Gephardt's statement will be made a part of the record, and he may summarize or proceed in whatever manner he sees fit.

Mr. Gephardt?

**STATEMENT OF HON. RICHARD A. GEPHARDT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI**

Mr. GEPHARDT. Thank you very much, Mr. Chairman, and thank you for allowing me to make my testimony now and to appear here today.

I want to commend your subcommittee for engaging in these hearings on the budget process and on this particular bill, which I support, and which has many merits.

I also hope that your subcommittee will endeavor in the next year to go ahead and look at the total Budget Act and help us on the Budget Committee, and all of us in the House, to make the changes that I think all of us feel need to be addressed as we review what has happened in the budget process in the last few years.

I think H.R. 4882 would be a very valuable change as we make a series of changes, if we do, in the budget process.

I was here for Jim Jones' testimony, and there isn't a lot that I can add on the technical side. I think he is absolutely correct that we have to be worried about measurement, we have to be worried about definition of tax expenditures, but I think both obstacles are surmountable.

I think we can do that and, as he said, at least we can know where we disagree. Even if we have to have votes on what is defined as a tax expenditure and what the measurement mechanism will be, we ought to go ahead and do that.

I think there are two overwhelming reasons to pass this kind of legislation. First, in terms of the overall sense of fairness about the budget.

We have in the last year, as you all well know, made some major cuts in spending. If everybody's prognostication is correct, we are going to face greater cuts in spending. As we go through that, I think the whole budget process won't blow apart if the American people not only foresee but know that what we are doing is fair.

The only way you can approach making it fair is to have in your calculation not only direct domestic spending and direct defense spending, but also tax expenditures. The only way they will be kept in mind and considered and dealt with is if they are included in the budget as called for by H.R. 4882.

The second thing I would say is that in terms of economic policy, we will do a lot better if we start making the connections between economic outcomes and direct and indirect spending.

As you know, these tax expenditures, as the former minority leader said, are across the board, touch more and more different parts of the Federal budget. Let me just mention a few, which I am sure you are aware of.

The Job Corps was established for the same goal as the targeted jobs tax credit. Grants for energy research and development have the same purpose as alternative fuel production tax credits. There we have duplications and overlapping with direct spending programs.

In other areas, tax expenditures conflict with established Federal policy. For example, while the Federal Reserve Board pursues a tight money policy, the tax deduction for interest is encouraging consumers to buy on credit.

We lose about \$6 billion a year from the consumer credit interest deduction, but we wonder why the credit boom has been so hard to slow.

Similarly, health planning agencies and PSRO's have been established to better allocate health care resources, but hospital construction, even where it is not needed, is encouraged through the exclusion of interest on hospital bonds.

As we all know, we have a huge tax exclusion on premiums paid by employers, which has, in my view, been the big fuel on health care costs.

The point is that not just from the point of view of fairness, as we go through budget deficit reduction exercises, but from the viewpoint of economic planning and policy, we have got to bring into focus what we are trying to do, both with direct spending programs and indirect spending programs. The only way we are going to do it is to get it up front, visible, in the budget process.

I even think we ought to break it down—I don't remember if your bill does this—but break it down by budget function so that we are forced not only to look at the aggregate of what we are spending indirectly, but to know where it is being spent and where the big dollar items are.

The last thing I would say is that I don't think measurement is going to be as tough or important as definition because measurement, at least the way I look at it, is not going to be a problem.

We can agree on some base of measurement and put that in the budget, and then the only way you are going to change that outcome is if you change the law on what you are allowing in terms of tax expenditures.

I think the whole point of the exercise is to make these tax expenditures visible and to force us to try to do a better job of understanding them, understanding their relationship, understanding their effect on fairness and economic outcomes.

That is really all I need to say.

[Mr. Gephardt's prepared statement follows:]

PREPARED STATEMENT OF HON. RICHARD A. GEPHARDT, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF MISSOURI

Mr. Chairman, I appreciate having this opportunity to testify on H.R. 4882, which provides for the inclusion of tax expenditure ceilings in the first and second budget resolutions.

This proposal raises a very important issue and addresses a need that has been neglected far too long.

As you well know, Mr. Chairman, on many occasions—before this committee and others—I have called for review of tax expenditures. Revenue losses due to special provisions of the tax code have a major budgetary and policy impact that takes on added significance as we try to pare back Federal spending and balance the budget.

In 1967, when tax expenditures were first officially compiled, the budget showed 50 items totaling \$36.6 billion in lost revenue, or 20.5 percent of direct outlays. In the revised fiscal year 1982 budget, 14 years later, the number of items had grown to 104 totaling \$266.3 billion, or more than 38 percent of total outlays—8 more items and expansion of 22 others were included in the Economic Recovery Act of 1981.

The impact of such sizable revenue losses on the Federal deficit, and thereby our economic policies, is readily apparent. Tax expenditures should not be excluded from the overall budgetary and fiscal picture that the congressional budget process was designed to review.

At the same time, tax expenditure items are designed to achieve specific policy goals, just as direct spending programs are developed to accomplish specified ends. The Job Corps, for example, was established toward the same goal as the targeted jobs tax credit. Grants for energy research and development have the same purposes as alternative fuel production tax credits. In many instances, tax expenditures duplicate or overlap with direct spending programs. In others, they conflict with established Federal policies. For example, while the Federal Reserve Board pursues a tight money policy, the tax deduction for interest is encouraging consumers to buy on credit. We lost about \$6 billion a year from the consumer credit interest deduction, but we wonder why the credit boom has been so hard to slow. Similarly, Health Planning Agencies and Professional Standards Review Organizations have been established to better allocate health care resources, but hospital construction, even where it is not needed, is encouraged through the exclusion of interest on hospital bonds.

A budget process designed to determine spending priorities can be only partially successful if it overlooks indirect subsidies through tax expenditures while it reviews direct spending alone.

The importance of focusing more attention on tax expenditures is greater than ever in this time of strenuous budget cutting. As it becomes more and more difficult to solve problems by enacting spending programs which expand the budget, the inclination to turn to the tax code to address national needs only naturally grows. While such action would not increase total outlays, it has no less effect on the deficit and is as important for budget policy as direct spending.

The Budget Act, as presently written, however, discourages more than a superficial look at tax expenditures. While it does call for setting an overall revenue floor, which reflects not just general tax policies but tax expenditures as well, amendment along the lines of that proposed by H.R. 4882 would highlight the two parts of that revenue number and give more appropriate recognition to their differences.

By requiring the budget resolution to establish a tax expenditure ceiling as well as a total revenue floor, the interaction between general and special purpose tax policies could be addressed. The budget process would permit better accommodation of tax expenditure items within the context of overall fiscal policy.

Simultaneously, this revision offers an opportunity to improve coordination of tax expenditures with direct spending. The proposal might even be carried one step further to establish tax expenditure ceilings by budget functions. This way, the resolution could more clearly identify the total contribution of Federal resources toward various budget priorities. It could discourage overlapping and help prevent conflicts between tax and spending programs.

The basic thrust of H.R. 4882 is highly desirable, but I do not want to fail to point out a potential problem with its implementation. Ever since tax expenditures have been identified in the budget, questions have persisted as to their definition and their measurement. Universal agreement has never been reached on all the provisions of the tax code that constitute tax expenditures. At the same time, tax analysts can only estimate the revenue loss due to specific credits and exclusions, and those calculations vary as tax rates are changed.

I will leave a more thorough discussion of these questions to those witnesses with greater expertise in budget and tax analysis, but I urge the committee to recognize the problem. It is similar to the difficulties we have experienced this fall with scorekeeping when the Budget Committees, CBO and OMB have disagreed over the savings and costs of appropriations and other measures. A similar conflict could develop over defining and measuring tax expenditures if a procedure is not established for resolving differences. Perhaps the Joint Tax Committee could be authorized to make such determinations with the concurrence of the full House and Senate.



The problems of definition and measurement are real, but not insurmountable. Above all, they should not stand in the way of action on H.R. 4882. This bill recognizes and addresses a very real need. For too long, the economic and policy impact of tax expenditures has been overlooked in the budget process. These items affect the deficit and alter budget priorities. Tax expenditures warrant closer attention, and they will get the review they should have under H.R. 4882.

Mr. LONG. Thank you, Mr. Gephardt. One comment.

Mr. Jones made the same comment as Mr. Bonior with respect to fairness, and you went into it in a little more detail than either of the two. I don't think that the American public has an understanding of the favorable treatment that many people are getting because of the tax expenditure. If this were really known, it would raise serious questions in the minds of the majority of the American people with respect to the fairness of the entire Internal Revenue program.

I think this is a very real danger that this institution has to face up to.

Mr. GEPHARDT. I agree with you, and I think that we will face up to it one way or the other. If we don't face up to it, I think we will be forced to do it because I think the budget process will just blow up in our face if we don't pay attention to that aspect of the deliberation.

Mr. LONG. Mr. Derrick?

Mr. DERRICK. I have no questions.

Mr. LONG. Mr. Bonior?

Mr. BONIOR. I would like to thank you, Dick, for coming in and giving us your feelings on this issue and your support for my proposal. I think, as the chairman indicated, the fairness issue is one that will not escape us much longer. The fact that we are dealing with 30 percent of the budget functionally each year is something that will have to be corrected, given the rising deficits.

It seems to me that the attention of the American public will be increasingly focused upon defense and this issue.

I think you really laid out very well the contradictions in direct spending programs and tax expenditures, especially in the hospital cost area. To your point on breaking it down even further, by budget functions, as your predecessor at that table has indicated, it is going to be difficult enough getting this into law by itself.

It may be that what you have suggested dealing with this by function, can be a subsequent action to that in which we are engaged right now, and may be a valuable one. I know—and I am sure Ms. Rivlin can speak for herself—but I know she has spoken to this in her testimony before the Senate, and I know it is something we will have to look at some point.

In closing, I would like to thank you for your help and your effort in your testimony this morning.

Mr. GEPHARDT. Thank you very much. I would like to follow up and say that I have been on the Ways and Means Committee for just 5 years. I have been through three major tax bills. It is clear to me that a tax bill is just a large spending bill. If anyone needed evidence of that, I think it is clear that the leasing provision that we passed, while it may be valuable and you may want to continue it for a lot of obvious reasons, is clearly a method of getting capital into corporations that are troubled in some cases.

It is clearly a subsidy to those corporations, such as the Chrysler bail-out bill, so I think in terms of fairness, in terms of economic outcome, in terms of where we are going economically, we have got to move this kind of proposal. I hope we will.

Mr. LONG. Thank you very much, Mr. Gephardt. We appreciate your coming and your contribution.

Mr. LONG. Our next witness is the distinguished Director of the Congressional Budget Office, Dr. Alice M. Rivlin.

Dr. Rivlin?

Is there objection to the inclusion of movie film with respect to the unanimous consent on taking photographs? Some people want to take some television or movie film. It would be the intention of the Chair to allow it, unless there is objection.

Hearing no objections, it is so ordered.

Ms. Rivlin?

#### STATEMENT OF ALICE M. RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Ms. RIVLIN. Thank you, Mr. Chairman.

I am delighted to be here to testify on H.R. 4882, which would incorporate limits on tax expenditures into the first and second congressional budget resolutions. It seems to me that this is an extremely important subject. I am delighted that you are holding these hearings. The major gaps in the budget process at the moment, it seems to us, are that tax expenditures are not included in a serious way and that credit is not yet fully included. Until those two major gaps in the budget control process are remedied, I think the Congress will not have a full set of tools for understanding and controlling the activities of the Federal Government that allocate resources in the country.

Other witnesses have talked this morning about the importance of controlling the rapid growth in tax expenditures and I won't go over those same numbers.

Tax expenditures, however you measure them, have grown rapidly. I think that growth is related to the Budget Act itself. Because we are now serious about controlling direct expenditures, an incentive has been created to carry out Federal activities through the tax expenditures route, which is not so directly controlled, and not so visible.

It is possible to define tax expenditures—there is some argument around the margins that I will come back to—and to allocate them under the same functions we use for direct spending. Those numbers are shown in table 2 on pages 4 and 5 of my prepared statement. [See pages 143 and 144.] We have also done a more detailed study of tax expenditures, entitled, "Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1982-86," which has been made available to the committee.

Let me move on, on page 6 of my prepared statement, to a discussion of H.R. 4882. This bill would incorporate limits on tax expenditures into the budget process by requiring that the first and second budget resolutions include a recommended level for total tax expenditures as well as for total revenues, and specify the amount by which both tax expenditures and revenues should be in-

creased or decreased. It would also subject tax expenditures to the point-of-order discipline of section 311 of the Budget Act, thereby making out of order any legislation that caused the recommended level of tax expenditures to be exceeded.

H.R. 4882 would thus sharpen the distinction between general revenue-reducing measures, such as rate cuts and increases in the standard deduction—zero bracket amount—and personal exemptions, and special-purpose tax provisions that seek to provide incentives for certain kinds of activities, or relief to those in special circumstances. This would enable the Congress to achieve more comprehensive control over the Federal Government's resource allocation activities. It would be harder for those programs or activities that are unable to obtain support on the direct spending side of the budget to obtain it through the back door of tax expenditures. It would also be easier to avoid the duplication and overlap that now can occur when similar programs are supported through both direct spending and tax expenditures. In other words, it seems to us to have a lot of advantages.

#### POSSIBLE DEFINITIONAL AND MEASUREMENT PROBLEMS

There are, of course, as Chairman Jones and others have mentioned, some definitional and measurement problems. I don't feel that those are as serious an obstacle as Chairman Jones does. They are clearly there, but I think they can be handled.

As to definitional problems, tax expenditures are defined in the Budget Act as the revenue losses attributable to provisions of the tax law that allow "a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." In general, tax expenditures are provisions that have some special purpose beyond simply defining taxable net income. Provisions that are part of the normal structure of the Tax Code—general rate schedules and exemption levels, general rules on who is subject to tax and what accounting periods should be used, and deductions for the costs of earning taxable income—are not classified as tax expenditures.

Inevitably there are some problems with borderline provisions. The just-enacted deduction for two-earner married couples, for example, is treated as a tax expenditure.

But if the Congress had adopted a broader approach and allowed married couples to be taxed separately at the lower rates applicable to single persons, the change would probably have been regarded as a modification of the basic tax structure rather than as a tax expenditure. The newly enacted accelerated cost recovery system of depreciation is another example. It could plausibly be argued that this is such a fundamental restructuring of business taxation that it represents a new tax system rather than a special incentive or tax expenditure designed to encourage business investment.

Despite these uncertainties at the margin, however, there has been almost complete agreement over the years between the Congress and the administration on which provisions of the Tax Code are special enough to be termed tax expenditures. In any event, disagreements over past classification decisions need not affect the decisions the Congress would have to make under H.R. 4882. If the

budget resolution required that tax expenditures be cut by \$5 billion, for example, and if there was any question about whether a provision that would be cut or eliminated was a tax expenditure, the Congress could make that decision for itself at the time. It would be no more difficult than a whole host of budget classification decisions that must be made all the time on the spending side of the budget.

Regarding measurement problems, as I discussed in detail in my testimony on November 24 before the Senate Budget Committee, there are certain difficulties in estimating the arithmetic total of all tax expenditures. Each individual tax expenditure estimate represents a good approximation of the revenue that would be gained if that provision did not exist and nothing else changed. But to estimate what total revenues would amount to if no tax expenditures existed would require, in effect, the construction of a whole new tax system. That is problematic.

Again, however, this problem with the arithmetic totals is generally not important as long as decisions are based only on incremental changes to the total, which is what you would be doing. If the budget resolution specifies that tax expenditures shall be reduced by \$5 billion, the only question is whether the legislative changes in question will have that effect. You don't have to worry about the total.

One question to be decided is how to treat changes in overall tax rates or the standard deduction—zero bracket amount—in budgeting tax expenditures. A reduction in income tax rates would reduce the revenue loss from all tax expenditures that take the form of deductions, exemptions, or exclusions from income, since the revenue loss is measured by multiplying the amount excluded by the relevant marginal rate. Similarly, increases in the standard deduction would reduce the revenue loss from all tax expenditures that take the form of itemized deductions. The Congress could, of course, decide that this kind of reduction in tax expenditures should not count for budget resolution purposes. The argument against such a rule is that reducing tax rates does, in fact, reduce the resource allocation effects of tax expenditures, and therefore account should be taken of this in the budget process. The problem does not seem intractable, however. It is probably one of those cases where the particular rule you choose is not as important as simply having a rule and having everybody know about it.

#### ADDITIONAL STEPS

As my testimony so far has indicated, I believe that H.R. 4882 represents an important and workable step toward improved control of tax expenditures. The committee may want to consider some additional steps, however.

In many cases, tax expenditures are quite similar in purpose to spending or loan programs. The purpose of both the targeted jobs tax credit and the Job Corps, for example, is to provide jobs for hard core unemployed youth. For residential energy conservation there are tax credits, grants, and loans. The Interior Department provides direct grants for historic preservation and also helps administer the tax incentives for historic preservation. Both the



Export-Import Bank and the Domestic International Sales Corporation tax provisions subsidize U.S. exports.

The committee may therefore want to explore ways of involving the committees with jurisdiction over analogous spending and loan programs more directly in the control of tax expenditures. These committees are likely to have more expertise in the program areas involved than the tax committees, and thus may be better able to give tax expenditure proposals a critical evaluation. They could determine more readily whether a tax expenditure would duplicate or overlap with similar spending programs and might be able to suggest ways of coordinating the administration of tax expenditures with that of similar spending programs.

The Rules of the House recognize the value of this kind of review by providing that: "Each standing committee of the House shall have the function of reviewing and studying on a continuing basis the impact or probable impact of tax policies affecting subjects within its jurisdiction."

The difficulty with this rule is that the non-tax committees have no real incentive to examine tax expenditures. Additional tax expenditures cost them nothing, and reductions in tax expenditures gain them nothing. If the budget process could be revised to make the involvement of these committees in decisions on tax expenditures more meaningful, congressional control over tax expenditures could be substantially enhanced.

As to greater involvement of spending committees, one way of doing this would be to break the tax expenditure budget down into separate budget functions, as is done with spending programs. Congressman Gephardt suggested that possibility. The tax expenditures in each function could then be allocated to the various committees with jurisdiction over analogous spending programs, by means of the same kind of "crosswalk" procedure that is used for spending allocations.

The Budget Act could be amended to require that all legislation providing for new or increased tax expenditures must be referred to the committee or committees with jurisdiction over analogous spending programs, after being approved by the House Ways and Means or Senate Finance Committee. The spending committee could recommend approval, approval with modifications, or disapproval. Its recommendation would then accompany the bill to the floor. This would be analogous to the procedure set out in section 401 of the Budget Act for review by the Appropriations Committees of bills providing new spending authority.

In order to make the review function serious, however, it would be important to insure that the decision had real consequences. One way to provide an incentive for serious review would be to tie a spending committee's spending allocations to the actions it takes on tax expenditure allocations. Its spending allocation could be reduced, for example, if the committee approved a tax expenditure that was referred to it. Or the spending committee could be permitted to recommend to the tax committee that a tax expenditure included in the spending committee's allocation be reduced or eliminated, and if the tax committee agreed, the spending committee's spending allocation could be increased.



Spending committees faced with the need to reduce spending on programs within their jurisdiction might recommend that tax expenditures allocated to them be reduced instead. The Energy Committee, for example, might recommend that the home insulation tax credit be reduced in order to provide additional funding for grant and loan programs for home insulation. The Public Works Committee might recommend that tax exempt industrial revenue bonds be limited in order to provide more funding for Economic Development Administration programs. The Banking Committee might recommend that the new tax provisions allowing more rapid depreciation for commercial and residential real property be scaled back in order to provide more funding for low- and moderate-income rental housing.

This all sounds very difficult, but it is a way of bringing these discussions together.

At a time like the present, when strict budget discipline is needed in all aspects of the Federal Government's activities, this procedure for forcing trade-offs between tax expenditures and direct spending could help to assure that the discipline is applied more uniformly to all forms of resource allocation and that the same careful review is given to tax expenditures that should be given to all forms of Federal resource allocation and intervention in the economy.

#### INITIAL EXPERIMENTATION

The jurisdictional and other questions that may arise with any new procedure of this kind suggest that it be tried in a limited and experimental way for a period of time before being fully implemented. The experience over the last few years with a credit budget, as Chairman Jones suggested, may be a useful guide. The Budget Committees and the Congress have voted on a separate nonbinding credit budget as part of budget resolutions for the last 2 years. As experience has been gained, and as more attention has been devoted to the analytic and practical problems that are involved, the Congress has reached a point at which firmer and more binding controls over the allocation of credit can be implemented.

The same procedure could be followed with tax expenditures. The Congress could start with the controls over aggregate tax expenditures provided in H.R. 4882, perhaps supplemented with function-by-function breakdowns for informational purposes and non-binding allocations to the spending committees. The Congress might then experiment with the referral of new or increased tax expenditures to spending committees that have very closely analogous spending programs within their jurisdiction. Approval might or might not entail reduction in the committee's spending allocations.

In conclusion, experience with the budget process has shown that it is adaptable to changing circumstances, even without formal amendment. I think we know enough already to say that the amendments included in H.R. 4882 would be workable and useful, but that it ought to be viewed simply as a first step toward making the control of tax expenditures more coordinated and equal with the control of direct expenditures.

Thank you.

[Ms. Rivlin's prepared statement follows:]

Statement of  
Alice M. Rivlin  
Director  
Congressional Budget Office  
before the  
Committee on Rules  
U.S. House of Representatives

December 9, 1981

I appreciate this opportunity to testify on H.R. 4882, which would incorporate limits on tax expenditures into the first and second Congressional budget resolutions. The proper treatment of tax expenditures is one of the important unresolved issues in the budget process. In September of this year, the Congressional Budget Office (CBO) issued a report entitled "Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1982-1986," which contains an extensive discussion of tax expenditures and the budget process. Copies of that report have been made available to the Committee.

My testimony this morning is divided into three sections. The first discusses the importance of controlling tax expenditures, the second discusses the specific provisions of H.R. 4882, and the third deals with additional steps the committee may want to consider.

THE IMPORTANCE OF CONTROLLING TAX EXPENDITURES

Tax expenditures have become one of the major ways in which the federal government allocates resources and affects private-sector decisions. In 1967, the first year for which an official tax expenditure budget was compiled, there were 50 items with a total revenue loss of \$36.6 billion--20.5 percent of total federal direct outlays in that year and 4.4 percent of the gross national product (GNP). By fiscal year 1981, tax expenditures had grown to a total of \$228.6 billion--34.6 percent of outlays and 8.0 percent of GNP (see Table 1). The most recent tax expenditure budget, compiled last March, included 104 items totaling \$266.3 billion for fiscal year 1982. The Economic Recovery Tax Act of 1981 added 8 new tax expenditures, expanded 22 others, and reduced 2.

TABLE 1. TAX EXPENDITURE GROWTH, CALENDAR YEARS 1967-1973 AND FISCAL YEARS 1975-1981<sup>a</sup>

|                                              | 1967   | 1969   | 1971   | 1973   | 1975   | 1977    | 1979    | 1981    |
|----------------------------------------------|--------|--------|--------|--------|--------|---------|---------|---------|
| Tax Expenditure Totals (millions of dollars) | 36,550 | 46,635 | 51,710 | 65,370 | 92,855 | 113,455 | 149,815 | 228,620 |
| Percent of GNP                               | 4.4    | 4.8    | 4.6    | 4.7    | 6.3    | 6.1     | 6.4     | 8.0     |
| Percent of Federal Outlays                   | 20.5   | 23.7   | 22.3   | 24.3   | 28.5   | 28.2    | 30.3    | 34.6    |
| Percent of Federal Revenues                  | 23.8   | 24.1   | 24.8   | 24.7   | 33.1   | 31.7    | 32.2    | 37.9    |
| Federal Outlays as a Percent of GNP          | 21.4   | 20.3   | 20.6   | 19.5   | 22.0   | 21.6    | 20.9    | 23.1    |

a. Tax expenditure estimates were prepared only on a calendar year basis for the years 1967 to 1973. The estimates for calendar years 1967 to 1973 correspond roughly to fiscal years 1968 to 1974, and are thus compared to the GNP, outlay, and revenue figures for those fiscal years.

In many areas, the federal government exerts more influence through tax expenditures than it does through direct spending. The tax expenditures for general purpose fiscal assistance are greater than direct federal outlays, for example, and tax expenditures for housing exceed outlays by more than four to one. Table 2 shows total tax expenditures and outlays by budget function for selected years between 1967 and 1981, and compares their rates of growth.

Tax expenditures add to the federal deficit in the same way that direct spending programs do. They allocate resources and provide incentives and benefits in the same way that spending programs do. They are one of the ways the federal government plays a role in the economy and involves itself in the lives of its citizens.

Unlike direct spending programs, however, tax expenditures have low visibility in the budget process and are controlled in only a limited and indirect way. The Budget Act requires that a tax expenditure budget be compiled each year, but it is presented only for informational purposes. No direct budgetary decisions are based on it, and accordingly it receives relatively little attention. One consequence of this low visi-

bility is that activities that may not have sufficient support to obtain federal funding through direct outlays may be funded through the back door by tax expenditures.

TABLE 2. GROWTH IN TAX EXPENDITURES AND OUTLAYS BY BUDGET FUNCTION, 1967-1981<sup>a</sup>

| Budget Function                                           | Amount<br>(in millions of dollars) |        |         | Rate of Growth<br>(Percent Increase/Decrease) |           |           |
|-----------------------------------------------------------|------------------------------------|--------|---------|-----------------------------------------------|-----------|-----------|
|                                                           | 1967 <sup>a</sup>                  | 1974   | 1981    | 1967-1974                                     | 1974-1981 | 1967-1981 |
| National Defense                                          |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 500                                | 715    | 1,755   | 43                                            | 145       | 251       |
| Outlays                                                   | 78,755                             | 77,781 | 159,699 | -1                                            | 105       | 103       |
| International Affairs                                     |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 290                                | 1,685  | 2,720   | 481                                           | 61        | 838       |
| Outlays                                                   | 5,267                              | 5,681  | 11,051  | 8                                             | 95        | 110       |
| General Science, Space<br>and Technology                  |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 500                                | 605    | 2,030   | 21                                            | 236       | 306       |
| Outlays                                                   | 5,519                              | 3,977  | 6,422   | -28                                           | 61        | 16        |
| Energy                                                    |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 1,605                              | 2,955  | 6,615   | 84                                            | 124       | 312       |
| Outlays                                                   | 1,006                              | 837    | 10,642  | -17                                           | 1,171     | 958       |
| Natural Resources<br>and Environment                      |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 130                                | 220    | 1,990   | 69                                            | 805       | 1,431     |
| Outlays                                                   | 2,996                              | 5,670  | 13,783  | 89                                            | 143       | 360       |
| Agriculture                                               |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 800                                | 1,300  | 1,435   | 63                                            | 10        | 79        |
| Outlays                                                   | 4,539                              | 2,227  | 5,598   | -51                                           | 151       | 23        |
| Commerce and Housing<br>Credit                            |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 12,115                             | 36,455 | 98,180  | 201                                           | 169       | 710       |
| Outlays                                                   | 4,331                              | 3,925  | 3,995   | -09                                           | 02        | -08       |
| Transportation                                            |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 10                                 | 970    | 35      | 9,600                                         | -96       | 250       |
| Outlays                                                   | 6,301                              | 9,172  | 23,312  | 46                                            | 154       | 270       |
| Community and Regional<br>Development                     |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 0                                  | 85     | 320     | NA                                            | 276       | NA        |
| Outlays                                                   | 1,381                              | 4,134  | 9,265   | 199                                           | 124       | 571       |
| Education, Training,<br>Employment and Social<br>Services |                                    |        |         |                                               |           |           |
| Tax Expenditures                                          | 3,095                              | 6,215  | 14,635  | 101                                           | 135       | 373       |
| Outlays                                                   | 7,632                              | 12,344 | 30,563  | 62                                            | 148       | 300       |

(Continued)



TABLE 2. (Continued)

| Budget Function                        | Amount<br>(in millions of dollars) |         |         | Rate of Growth<br>(Percent Increase/Decrease) |           |           |
|----------------------------------------|------------------------------------|---------|---------|-----------------------------------------------|-----------|-----------|
|                                        | 1967 <sup>a</sup>                  | 1974    | 1981    | 1967-1974                                     | 1974-1981 | 1967-1981 |
| Health                                 |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 2,600                              | 5,065   | 19,945  | 93                                            | 294       | 667       |
| Outlays                                | 9,708                              | 22,073  | 69,324  | 127                                           | 214       | 614       |
| Income Security                        |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 9,675                              | 13,760  | 52,030  | 42                                            | 278       | 438       |
| Outlays                                | 33,683                             | 84,437  | 225,599 | 151                                           | 167       | 570       |
| Veterans' Benefits<br>and Services     |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 550                                | 800     | 1,565   | 45                                            | 96        | 185       |
| Outlays                                | 6,882                              | 13,386  | 22,937  | 95                                            | 71        | 233       |
| Administration of<br>Justice           |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 0                                  | 0       | 0       | NA                                            | NA        | NA        |
| Outlays                                | 650                                | 2,462   | 4,721   | 279                                           | 92        | 626       |
| General Government                     |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 0                                  | 10      | 100     | NA                                            | 900       | NA        |
| Outlays                                | 1,552                              | 3,243   | 4,730   | 109                                           | 46        | 205       |
| General Purpose                        |                                    |         |         |                                               |           |           |
| Fiscal Assistance                      |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 4,680                              | 11,175  | 25,340  | 139                                           | 127       | 441       |
| Outlays                                | 340                                | 6,890   | 6,621   | 1,926                                         | -4        | 1,847     |
| Interest                               |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 0                                  | 0       | -75     | NA                                            | NA        | NA        |
| Outlays                                | 13,751                             | 28,032  | 82,590  | 104                                           | 195       | 501       |
| Undistributed Off-<br>setting receipts |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 0                                  | 0       | 0       | NA                                            | NA        | NA        |
| Outlays                                | -5,460                             | -16,651 | -30,306 | 205                                           | 82        | 455       |
| Total                                  |                                    |         |         |                                               |           |           |
| Tax Expenditures                       | 36,550                             | 82,015  | 228,620 | 124                                           | 179       | 525       |
| Outlays                                | 178,833                            | 289,620 | 680,544 | 51                                            | 145       | 269       |

NOTE: NA = not applicable

- a. Tax expenditure estimates were prepared only on a calendar year basis for the years 1967 to 1973. The estimate for calendar year 1967 corresponds roughly to fiscal year 1968, and is therefore compared to the outlays for that year.

Tax expenditures show up as revenue losses, and thus have an important effect on the revenue totals that are included in Congressional budget resolutions. But they are treated for this purpose as simply another form of tax cut; they are not treated as alternatives to spending programs. There is an important distinction between general tax cuts that reduce taxes broadly across the board, and tax expenditures that provide a tax cut only to those in certain specified circumstances, or who act in certain specified ways. General tax cuts return resources to taxpayers to use in whatever way they see fit; tax expenditures return resources to taxpayers only if they do what the government would like them to do, or if they are thought deserving of special help. The present treatment of tax expenditures in the budget process blurs the distinction between these two ways of reducing taxes.

#### H.R. 4882

H.R. 4882 would incorporate limits on tax expenditures into the budget process by requiring that the first and second budget resolutions include a recommended level for total tax expenditures as well as for total revenues, and specify the amount by which both tax expenditures and revenues should be increased or decreased. It would also subject tax expenditures to the point-of-order discipline of Section 311 of the Budget Act, thereby making out of order any legislation that caused the recommended level of tax expenditures to be exceeded.

H.R. 4882 would thus sharpen the distinction between general revenue-reducing measures, such as rate cuts and increases in the standard deduction (zero bracket amount) and personal exemptions, and special-purpose tax provisions that seek to provide incentives for certain kinds of activities, or relief to those in special circumstances. This would enable the Congress to achieve more comprehensive control over the federal government's resource allocation activities. It would be harder for those programs or activities that are unable to obtain support on the direct spending side of the budget to obtain it through the back door of tax expenditures. And it would be easier to avoid the duplication and overlap that can now occur when similar programs are supported through both direct spending and tax expenditures.

### Possible Definitional and Measurement Problems

As the CBO report I referred to earlier discusses in more detail, there are some problems in defining and measuring tax expenditures. These problems affect mainly the current total of tax expenditures--the base from which H.R. 4882 would begin. Under H.R. 4882, however, decisions are only required on relatively small additions to or subtractions from that base. The definitional and measurement problems with respect to these incremental decisions are minor.

Definitional Problems. Tax expenditures are defined in the Budget Act as the revenue losses attributable to provisions of the tax law that allow "a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." In general, tax expenditures are provisions that have some special purpose beyond simply defining taxable net income. Provisions that are part of the normal structure of the tax code--general rate schedules and exemption levels, general rules on who is subject to tax and what accounting periods should be used, and deductions for the costs of earning taxable income--are not classified as tax expenditures.

Inevitably there are some problems with borderline provisions. The just-enacted deduction for two-earner married couples, for example, is treated as a tax expenditure. But if the Congress had adopted a broader approach and allowed married couples to be taxed separately at the lower rates applicable to single persons, the change would probably have been regarded as a modification of the basic tax structure rather than as a tax expenditure. The newly enacted Accelerated Cost Recovery System of depreciation is another example. It could plausibly be argued that this is such a fundamental restructuring of business taxation that it represents a new tax system rather than a special incentive or tax expenditure designed to encourage business investment.

Despite these uncertainties at the margin, however, there has been almost complete agreement over the years between the Congress and the Administration on which provisions of the tax code are "special" enough to be termed tax expenditures. In any event, disagreements over past classification decisions need not affect the decisions the Congress would have to make under H.R. 4882. If the budget resolution required that tax expenditures be cut by \$5 billion, for example, and if there was any

question about whether a provision that would be cut or eliminated was a tax expenditure, the Congress could make that decision for itself at the time. It would be no more difficult than a whole host of budget classification decisions that must be made all the time on the spending side of the budget.

Measurement Problems. As I discussed in detail in my testimony on November 24 before the Senate Budget Committee, there are certain difficulties in estimating the arithmetic total of all tax expenditures. Each individual tax expenditure estimate represents a good approximation of the revenue that would be gained if that provision did not exist and nothing else changed. But to estimate what total revenues would amount to if no tax expenditures existed would require, in effect, the construction of a whole new tax system. The resulting tax increases would be so large that they would produce fundamental changes in the economy that would themselves have dramatic effects on revenue collections. Such an estimate could be made, but it would be so sensitive to the assumptions made about the economic effects that the assumptions would largely determine the results.

Again, however, this problem with the arithmetic totals is generally not important as long as decisions are based only on incremental changes to the total. If the budget resolution specifies that tax expenditures shall be reduced by \$5 billion, the only question is whether the legislative changes in question will have that effect.

One question to be decided is how to treat changes in overall tax rates or the standard deduction (zero bracket amount) in budgeting tax expenditures. A reduction in income tax rates would reduce the revenue loss from all tax expenditures that take the form of deductions, exemptions, or exclusions from income, since the revenue loss is measured by multiplying the amount excluded by the relevant marginal rate. Similarly, increases in the standard deduction would reduce the revenue loss from all tax expenditures that take the form of itemized deductions. The Congress could, of course, decide that this kind of reduction in tax expenditures should not count for budget resolution purposes. The argument against such a rule is that reducing tax rates does in fact reduce the resource allocation effects of tax expenditures, and therefore account should be taken of this in the budget process. The

problem does not seem intractable, however. It is probably one of those cases where the particular rule you choose is not as important as simply having a rule.

#### ADDITIONAL STEPS

As my testimony so far has indicated, I believe that H.R. 4882 represents an important and workable step toward improved control of tax expenditures. The Committee may want to consider some additional steps, however.

In many cases, tax expenditures are quite similar in purpose to spending or loan programs. The purpose of both the targeted jobs tax credit and the Job Corps, for example, is to provide jobs for hard-core unemployed youth. For residential energy conservation there are tax credits, grants, and loans. The Interior Department provides direct grants for historic preservation and also helps administer the tax incentives for historic preservation. Both the Export-Import Bank and the Domestic International Sales Corporation (DISC) tax provisions subsidize U.S. exports.

The Committee may therefore want to explore ways of involving the committees with jurisdiction over analogous spending and loan programs more directly in the control of tax expenditures. These committees are likely to have more expertise in the program areas involved than the tax committees, and thus may be better able to give tax expenditure proposals a critical evaluation. They could determine more readily whether a tax expenditure would duplicate or overlap with similar spending programs, and might be able to suggest ways of coordinating the administration of tax expenditures with that of similar spending programs. They might also help to prevent those who are unable to obtain federal assistance through grant or loan programs from making end runs around the budget process and obtaining it through tax expenditures.

The Rules of the House recognize the value of this kind of review by providing that:

Each standing committee of the House shall have the function of reviewing and studying on a continuing basis the impact or probable impact of tax policies affecting subjects within its jurisdiction . . .

(Rule X 2.(d))



The difficulty with this rule is that the non-tax committees have no real incentive to examine tax expenditures. Additional tax expenditures cost them nothing, and reductions in tax expenditures gain them nothing. If the budget process could be revised to make the involvement of these committees in decisions on tax expenditures more meaningful, Congressional control over tax expenditures could be substantially enhanced.

#### Greater Involvement of Spending Committees

One way of doing this would be to break the tax expenditure budget down into separate budget functions, as is done with spending programs. The tax expenditures in each function could then be allocated to the various committees with jurisdiction over analogous spending programs, by means of the same kind of "crosswalk" procedure that is used for spending allocations.

The Budget Act could be amended to require that all legislation providing for new or increased tax expenditures must be referred to the committee or committees with jurisdiction over analogous spending programs, after being approved by the House Ways and Means or Senate Finance Committee. The spending committee could recommend approval, approval with modifications, or disapproval. Its recommendation would then accompany the bill to the floor. This would be analogous to the procedure set out in Section 401 of the Budget Act for review by the Appropriations Committees of bills providing new spending authority.

In order to make the review function serious, however, it would be important to ensure that the decision had real consequences. One way to provide an incentive for serious review would be to tie a spending committee's spending allocations to the actions it takes on tax expenditure allocations. Its spending allocation could be reduced, for example, if the committee approved a tax expenditure that was referred to it. Or the spending committee could be permitted to recommend to the tax committee that a tax expenditure included in the spending committee's allocation be reduced or eliminated, and if the tax committee agreed, the spending committee's spending allocation could be increased. Spending committees faced with the need to reduce spending on programs within their jurisdiction might recommend that tax expenditures allocated to them be reduced instead. The energy committee, for example, might

recommend that the home insulation tax credit be reduced in order to provide additional funding for grant and loan programs for home insulation. The public works committee might recommend that tax-exempt industrial revenue bonds be limited in order to provide more funding for Economic Development Administration programs. The banking committee might recommend that the new tax provisions allowing more rapid depreciation for commercial and residential real property be scaled back in order to provide more funding for low- and moderate-income rental housing.

At a time like the present, when strict budget discipline is needed in all aspects of the federal government's activities, this procedure for forcing trade-offs between tax expenditures and direct spending could help to assure that the discipline is applied more uniformly to all forms of resource allocation and that the same careful review is given to tax expenditures that should be given to all forms of federal resource allocation and intervention in the economy.

#### Initial Experimentation

The jurisdictional and other questions that may arise with any new procedure of this kind suggest that it be tried in a limited and experimental way for a period of time before being fully implemented. The experience over the last few years with a credit budget may be a useful guide. The Budget Committees and the Congress have voted on a separate nonbinding credit budget as part of budget resolutions for the last two years. As experience has been gained, and as more attention has been devoted to the analytic and practical problems that are involved, the Congress has reached a point at which firmer and more binding controls over the allocation of credit can be implemented.

The same procedure could be followed with tax expenditures. The Congress could start with the controls over aggregate tax expenditures provided in H.R. 4882, perhaps supplemented with function-by-function breakdowns for informational purposes, and nonbinding allocations to the spending committees. The Congress might then experiment with the referral of new or increased tax expenditures to spending committees that have very closely analogous spending programs within their jurisdiction. Approval might or might not entail reduction in the committees' spending allocations.

CONCLUSION

Experience with the budget process has shown that it is adaptable to changing circumstances, even without formal amendment. I think we know enough already to say that the amendments included in H.R. 4882 would be workable and useful. The Congress could experiment further with additional controls over tax expenditures, just as it has with controls over credit. As more experience and knowledge is gained, and a consensus begins to form, the new procedures could be formally institutionalized by amendments to the Budget Act. The important thing, however, is to start. Tax expenditures are too important a part of the federal activities to be left free from direct control under the budget process.

Mr. LONG. Thank you very much, Dr. Rivlin.

Mr. Derrick?

Mr. DERRICK. Thank you.

Dr. Rivlin, could you tell me how you feel about the argument that tax expenditures ought not to be included in the budgeting process, that to do so would not allow the business community enough lead time to plan for the future? That has been one of the great arguments I have heard.

Ms. RIVLIN. I don't know why that should be true. It is certainly not desirable to change the tax code every year, and to have a great deal of uncertainty.

Mr. DERRICK. Of course the argument is if you start this, it is subject to being changed every year.

Ms. RIVLIN. I think that the Congress should consider that argument. There should perhaps, be a bias against frequent change. But I think that possibility is simply outweighed by the importance of having a regular way of considering how resources are used.

I don't think that there is anything special about the tax side of the budget. It is very difficult when spending programs are changed every year, too. In general, we need more continuity on both sides, but I don't see anything special about that.

Mr. DERRICK. That may be true on the spending side, but most of these tax expenditures, or a large number, have to do with long-range planning, depreciation schedules, interest and so forth.

Thank you.

Ms. RIVLIN. If I may pursue this question, I don't think you would necessarily get more frequent change. You might get less, and you might eventually get rid of some kinds of change altogether—just having less tax expenditures.

Mr. DERRICK. Thank you.

Mr. LONG. Mr. Bonior?

Mr. BONIOR. To follow up on Mr. Derrick's comments, I notice that when Mr. Long had hearings on sunseting tax expenditures, there were some complaints, that business needs predictability of continuity to make some business decisions. However, some of our tax expenditures are sunsetted, are they not?

Ms. RIVLIN. Yes, they are.

Mr. BONIOR. Do you know what the percentage is offhand that reach a sunset stage?

Ms. RIVLIN. I don't think it is a large percentage, although I do have a list of those that are. Let us introduce for the record a list of those that are sunsetted. [See p. 153.] It is a not a large percentage of the total.

Mr. VERDIER. About 10 percent.

Mr. BONIOR. I have looked at the studies. Have there been any studies performed concerning the percentage of corporate tax expenditures that are claimed by small business and, if not, is such an analysis possible?

Ms. RIVLIN. I don't know of any. Let me again turn to Jim Verdier, who is our Assistant Director for Tax Analysis.

Mr. VERDIER. There have been some studies done of the effect of some of the larger provisions, such as accelerated depreciation and the investment tax credit, but there hasn't been a systematic effort to show the distribution by size of business, nor to show what the effect of business tax expenditures would be on individuals because then you get into the question of who bears the burden of the corporate income tax.

Mr. BONIOR. I want to thank you for your testimony. I think it has been helpful, I am glad that you are supportive, and I hope that we can continue with this discussion through our hearing process because, as I indicated, I think it is an important issue that has to eventually be faced by the Congress.

One final comment that I would like to make is that one of the problems we have in dealing with the suggestion that Mr. Gephardt made, and you have made on separate occasions, about dealing by budget functions in the various committees is the political problem of doing that. Of course, that is not your problem, that is our problem.

Ms. RIVLIN. That is your problem.

Mr. BONIOR. But the way the system has developed in this body on a constituent basis the special interests affected by those committees might indeed make it very difficult for us to control the problem that is out there on the chart—the growth in tax expenditures.

I think that is a political problem that we will have to grapple with.

I thank you.

The CHAIRMAN. Thank you. I have no questions, having just arrived. I am delighted to see you here and appreciate your continuing interest in this problem.

Ms. RIVLIN. Thank you, Mr. Chairman. Let me say I am especially delighted to see you here.

The CHAIRMAN. Thank you.

[The list Ms. Rivlin referred to follows:]

## TAX EXPENDITURES WITH EXPIRATION DATES

| Tax Expenditure                                                                         | Expiration Date   |
|-----------------------------------------------------------------------------------------|-------------------|
| Five-year amortization of on-the-job training and child care facilities                 | December 31, 1981 |
| \$200/400 interest and dividend exclusion                                               | December 31, 1981 |
| Business alternative energy investment tax credits                                      | December 31, 1982 |
| Credit for cogeneration equipment                                                       | December 31, 1982 |
| Deduction for eliminating architectural and transportation barriers for the handicapped | December 31, 1982 |
| Employee stock ownership plan (ESOP) investment tax credit                              | December 31, 1982 |
| Tax-exempt savings certificates                                                         | December 31, 1982 |
| Targeted jobs tax credit                                                                | December 31, 1982 |
| Exclusion for employer educational assistance programs                                  | December 31, 1983 |
| Five-year amortization of low-income rental housing rehabilitation expenses             | December 31, 1983 |
| Exclusion for group prepaid legal services                                              | December 31, 1984 |
| Tax-exempt bonds for purchase of mass transit equipment                                 | December 31, 1984 |
| Exclusion for employer-provided transportation                                          | December 31, 1985 |
| Credit for intercity buses                                                              | December 31, 1985 |
| Credit for ocean thermal energy conversion equipment                                    | December 31, 1985 |
| Credit for small-scale hydroelectric facilities                                         | December 31, 1985 |
| Home insulation tax credit                                                              | December 31, 1985 |
| Investment credit for commuter vans                                                     | December 31, 1985 |
| Solar energy tax credit                                                                 | December 31, 1985 |
| Tax-exempt bonds for small-scale hydroelectric facilities                               | December 31, 1985 |
| Tax credit for research and experimentation                                             | December 31, 1985 |
| Charitable contribution deduction for nonitemizers                                      | December 31, 1986 |
| Alcohol fuel tax credit                                                                 | December 31, 1992 |
| Alternative fuel production credit                                                      | December 31, 2000 |



The CHAIRMAN. The next witness is Mr. W. Bowman Cutter, former Associate Director of the Office of Management and Budget. We are delighted to have you.

**STATEMENT OF W. BOWMAN CUTTER, PARTNER, COOPERS AND LYBRAND, AND FORMER ASSOCIATE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET**

Mr. CUTTER. Mr. Chairman, it is a pleasure to be here.

Mr. Chairman, I have a very brief statement, and I will paraphrase even that brief statement.

The CHAIRMAN. You may proceed as you wish. The full statement will be included in the record without objection.

Mr. CUTTER. Thank you, sir.

It is an honor to be asked here. I have testified before this committee in the past and appreciate the opportunity to do it again. I want particularly to say that I fully support this committee's ongoing efforts, which certainly occurred throughout the period of time that I was in the Government, and am glad to see it continued to examine changes and positions in the budget process.

I think the work done in the past few years on sunset was important and valuable, and I think this is a valuable step.

I appear today in support of the intent of H.R. 4882, which amends the Congressional Budget Act of 1974 to require the congressional budget resolution to fix levels for tax expenditures, as well as for Federal revenues; that is to say, as a former Federal budget official, I fully support and I regard it as a matter of some urgency an effort to extend budget control to tax expenditures.

I believe tax expenditures are an important aspect of government activity, one that is considerably less visible than others, and one that will grow in importance as spending budgets become more and more difficult. Beyond this expression of general support, there are several brief comments that I would like to make.

First, there are ambiguities of definition in the concept of tax expenditures. I won't go into them. Every speaker before me has mentioned them.

My own judgment is that they can be resolved. My further judgment, though, is that I tend to share the caution of Chairman Jones, not because I think that the definitions themselves are so inordinately difficult, but because I think that the budget process itself is becoming so complex that ambiguity is something that ought to be resolved by the slow definition of rigorous procedure, and therefore I tend to share that caution while fully supporting the intent of the legislation.

Second, tax expenditures clearly bear some resemblance to entitlements. Once in law, they are virtually never examined by the Congress. I would suggest, as have all the speakers before me, that the Budget Committees begin to categorize tax expenditures by budget function and consider them along with programmatic spending in the same categories. This might provide a stimulus to the programmatic analysis of tax expenditures.

Once again, I understand the political and tough difficulties that that gives rise to, but I would like to underline that perhaps a little bit harder than Ms. Rivlin did, that from my point of view, a de-

financed functional and programmatic examination of tax expenditures is the sine qua non of the successful effort to extend the budget process to tax expenditures.

In our own experience, in the Federal Government, as we looked at this, a judgment simply at the level of totals tended to impose little or no discipline upon the pieces. While I fully understand the difficulties, I fully understand the concerns that will give rise, I understand that things come in time, nevertheless I think that it is an absolutely crucial part of any effort to extend budgetary control of tax expenditures.

Third, and I think that this is an aspect of that second point, within the executive branch, tax expenditure analysis has no natural home. The Treasury Department has responsibility for revenue estimating and the structure of the tax system, but it frequently lacks the programmatic knowledge to look at tax expenditures rigorously.

The departments considered related tax expenditures as free goods. They don't pay for them and they see no effort to analyze them and do much about them on the Hill.

OMB began a few years ago to consider tax expenditures explicitly. I hope that effort continues, but once again, unless there is a concomitant effort on the Hill, an OMB effort is an effort in a vacuum in the executive branch and is frequently simply ignored by the agencies, or not given sufficient emphasis.

Finally, and a point that I think needs to be emphasized, the tax expenditures are not automatically bad or without merit and the magnitudes often mentioned, well in excess of \$200 billion, do not represent an easily available pot of money.

The tax expenditures represent the specific intent of past Congresses to provide certain incentives or to distribute income in particular ways. Many of the purposes remain valid, and in addition, no matter what we call it, reducing or eliminating the tax expenditure appears to the taxpayer as a tax increase. It is not immediately apparent to me that there is much budget flexibility to be found via tax increases in the next few years.

In conclusion, I fully support the intent of this legislation. I would leave it to the members of the Budget Committee to discuss what is the most appropriate means of bringing tax expenditures into the congressional budget process.

As a general statement and as a general principle, as resources become more and more scarce, and as our spending difficulties become more and more obvious, it seems to me more and more important to extend the budget process to major areas of resource use to which it has not yet been extended.

Thank you very much.

[Mr. Cutter's prepared statement follows:]

Testimony of  
W. Bowman Cutter  
Partner, Coopers & Lybrand  
Before the House Rules Committee  
December 9, 1981

Mr. Chairman:

It is an honor to be asked to testify once again before your Committee. As you know, I have testified before the Committee on numerous occasions in the past; I welcome this opportunity today.

I appear here today in general support of the intent of H.R. 4881, which amends the Congressional Budget Act of 1974 to require the Congressional Budget Resolutions to fix levels for tax expenditures as well as for federal revenues. I believe tax expenditures to be an important aspect of government activity, one that is frequently less visible than others and one that will grow in importance as spending budgets become more and more difficult. Beyond this expression of general support there are several brief comments I should like to make.

First, there are ambiguities of definition in the concept of tax expenditures. As many have pointed out, the furthest (and absurd) limit of the concept would include all income left untaxed. Clearly this would be nonsense. But if the concept is now to enter into law -- rather than remaining simply a useful analytic tool -- then definitions need to be established. I would suggest that the CBO be requested to provide a useful working definition. In particular, it is not clear today what the aggregate level of tax expenditures is.

Second, tax expenditures clearly bear resemblance to entitlements. Once in law they are virtually never examined again by the Congress.

I would suggest that the Budget Committee begin to categorize tax expenditures by budget function and consider them along with programmatic spending in the same categories. This might provide stimulus to the programmatic analysis of tax expenditures.

Third, within the Executive Branch tax expenditure analysis has no currently natural home. The Treasury Department has responsibility for revenue estimating and the structure of the tax system but frequently lacks the programmatic knowledge to assess them. The Departments consider related tax expenditures as free goods. They do not pay for them so why should they bother analyzing them or waste political capital in any effort to change them? OMB began a few years ago to consider tax expenditures explicitly; I hope that effort continues. But a defined congressional process would provide support for further development of an Executive Branch process.

Fourth, it needs to be emphasized that tax expenditures are not automatically bad or without merit and that the magnitudes often mentioned -- exceeding \$200 billion -- do not represent easily available pots of money. Tax expenditures represent the specific intent of past Congresses to provide certain incentives or distribute income in certain ways. Many of these purposes remain valid. In addition, no matter what we call it, reducing or eliminating a tax expenditure appears to the tax payer as a tax increase. It is not immediately apparent that there is much budget flexibility to be found via tax increases.

In conclusion, I fully support the intent of this legislation. I will leave it to members of the Budget Committee to discuss what is the most appropriate means of bringing tax expenditures into the congressional budget process. As a general principle, as budget resources become more and more scarce it makes very little sense to exclude from the Congress' budget making process a category of resource as important as tax expenditures.



The CHAIRMAN. Thank you very much. Thank you for coming to this meeting.

The committee, I guess, has showed a continuing interest in this question, and I think it is safe for me to say that the other committees haven't been startlingly interested in dealing with it and, in fact, have been at least passive.

If this committee doesn't continue to show an interest, I doubt very seriously that anything much is going to be done about it.

I think the point that you made about the need to define precisely what we are talking about is extremely important because the opponents of even discussing tax expenditures are really trying to confuse the issue rather than clarify.

They I guess believe what they say; that is, that a tax expenditure is somehow entirely different than an appropriation expenditure. It is a transition that they make that I find very hard to understand, except in terms of self-interest. I don't understand it in terms of logic, so I very much appreciate your being here and adding to the hearing.

Mr. Derrick?

Mr. CUTTER. May I underline a point you made?

The CHAIRMAN. Of course.

Mr. CUTTER. Time after time after time, when I was at OMB, we not only looked at tax expenditures as essentially the equivalent of spending programs, but we proposed them as such, and analyzed them specifically in the budget as such.

The entire range of tax expenditure provisions in the area of alternative fuels, which I would hasten to say I support, proposed most of them and continue to support them, nevertheless were always regarded as the mirror image of direct spending programs. We always felt that they should be considered in the light of direct spending programs in future budget decisions.

I entirely agree with the point that you made.

The CHAIRMAN. Thank you. That is a very important point, and I am glad you made it.

Mr. Derrick?

Mr. DERRICK. Thank you, Mr. Chairman.

Would you comment on the question that I asked Dr. Rivlin concerning the issue of long-term business planning and the effect of including tax expenditures in the budget on such planning?

Mr. CUTTER. Congressman Derrick, I had a feeling you were going to ask me that. One of the things I do now in the private sector is structure major financings. There is no question whatsoever that tax issues is an important part of any kind of financial structure.

I think that as I listened to the answer to your question and to the answers that Ms. Rivlin gave, my judgment was that, as in all issues, there are advantages and there are disadvantages that one cannot entirely wave away; that I do think that the longrun ability to plan a capital expenditure program, to plan the way one will finance major programs, is important in capital investment and in innovation.

I do think that frequent changes in the tax code runs against that, and that is a disadvantage to look into tax expenditures.



I don't see how anyone can deny that, but I look at that number over there and I come to the judgment that it is a relatively small disadvantage, that it does not loom large to me.

When I look down that long list of tax expenditure items, the vast number of them would not affect capital investment, nor would they affect innovation in our society, were they to be examined in a fair and rigorous way over time.

So, I guess I come down thinking that it is a fair point, but I don't weigh it very heavily.

Mr. DERRICK. Thank you.

Mr. LONG. Mr. Bonior?

Mr. BONIOR. Mr. Cutter, I would like to thank you for appearing and lending your expertise to this issue. Your comments on definition are well taken. I think the committee ought to bear those in mind in considering what we may or may not do in the future with this issue.

Just to underscore your comments on budget functions, I testified earlier that, in certain areas, by function we spend more through tax expenditures than we do through direct spending. Energy and housing, for example. I think the relation between direct expenditures and tax expenditures needs to be made and needs to be focused at those jurisdictional levels so we can make some intelligent decisions.

I thank you for raising that and highlighting that in your testimony. I have no further comments.

Mr. LONG. Mr. Cutter, I was not here at the time. Did you have a prepared statement?

Mr. CUTTER. I had a prepared statement, and I paraphrased it.

Mr. LONG. It has been made a part of the record. Also, without objection, Dr. Rivlin's statement will be made part of the record.

Thank you, Mr. Cutter. We are very appreciative of your taking the time and sharing with us the benefits of your views in this matter.

Mr. CUTTER. Thank you, sir. It is a pleasure to be here.

Mr. LONG. Dr. Schick has been an adviser to this committee and many other committees for a number of years. We are pleased to have you sit on that side of the table.

#### STATEMENT OF ALLEN SCHICK, SCHOOL OF PUBLIC AFFAIRS, UNIVERSITY OF MARYLAND

Mr. SCHICK. I would discuss various parts of my statement and would request that the entire statement be placed in the record.

Mr. LONG. Without objection, so ordered.

Mr. SCHICK. I would like to address two related issues which seem to affect this committee and it will have to come to grips with if it recommends legislation with respect to tax expenditures.

One is the extent to which tax expenditures are the functional equivalent of direct expenditures. The other is the extent to which tax expenditures can be estimated so that they can be controlled through a budget process.

With respect to estimation, it should be clear that there are problems. Some of them are definitional. What is a tax expenditure? To what extent do we distinguish between the structural elements of

the tax system and the programmatic ones? There are problems which arise out of the unknown future of tax expenditures.

In my statement I point to the pending implementation of the expanded IRA program, which at the time it was enacted just a few months ago seemed to involve a smaller loss of Federal revenues than is now projected.

We already know with respect to the sale or the pro forma sale of depreciation leases of the tax loss, so we have that problem as well.

We also have the problem that the loss to the Treasury from tax expenditures depends as much on the behavior of taxpayers as it does on the actions of Congress, the extent to which they avail themselves of these opportunities.

Despite this, I believe that it is relatively easy to budget for tax expenditures, and because the very problems I just identified appear in equal measure on its direct spending side of the ledger, that is anyone who makes budget decisions, and this year's budget and reconciliation exercise certainly is consistent with that, knows that at any moment in time you are dealing with budget numbers that are going to be changed, and that what finally eventuates might not necessarily be the same as was projected when the decisions were initially made.

Any budget system for direct spending for tax spending operates under uncertainty and depends on estimates rather than on actuals, for the simple reason that a budget deals with the future, not with the past.

But two things are important for budget controls to work. First, that estimates be as reliable as possible, although they are still only estimates, that they not be deliberately tampered with by the makers of budget policy; second, that participants in the budget process use a common set of estimates, such as a baseline, so that when they discuss budget issues, they can work off that baseline and speak the same language.

So it turns out that although estimates of tax expenditure are a matter of uncertainty and even of controversy, this feature does not lessen their controllability by the budget process.

I would reinforce this by pointing to something that Dr. Rivlin said in her statement, that what is very important for the Congress is the incremental change made by tax legislation, not the extent to which the Federal Government will raise \$700 billion of revenues or a different amount of revenues, but how much less will be raised by the Federal Government as it changes provisions of the tax laws. As a consequence, I believe it is easy to grapple with this incremental issue by developing the baseline procedures I mentioned.

The second problem I bring to the committee is more troublesome; that is, are direct tax expenditures equivalent to one another.

Members are well aware of the ideological arguments that on the one hand tax expenditures have a subsidy effect equivalent to direct expenditures. On the other hand, taxpayers tend to see them as income retained rather than as grants from the government.

I believe that while it is important to budget for tax expenditures, it would be erroneous and misleading to completely oblit-

erate the differences between tax and direct spending. Let me offer a few reasons.

The chart over here is a useful way of focusing on the issue. We tend to define tax expenditures as independent from the overall tax system, the basic rates which Dr. Rivlin addressed in her statement, what we technically call the structural features of the tax system as opposed to the special or the programmatic features, which are defined as tax expenditures.

It turns out, however, that the structural and the programmatic features are not separate from one another. First, they are not separate because we would not tolerate the particular tax structure we had, if we didn't also have the tax expenditures; that is, we would not have effective rates of taxation equivalent to the nominal rates shown in the tax system.

Put it this way. If we were to abolish all tax expenditures, we would be changing the structural system. Conversely, if you change the basic tax structure, you automatically change its value; that is, the estimates of tax expenditures as well.

It turns out that the main reason—not the only reason, but the main reason—for the enormous growth in tax expenditures between 1972 and 1982 as portrayed on the chart is not the action of Congress but changes in the productivity of the basic tax system; that is, as the tax system becomes more productive, either because of inflation or because of expansion of the economy, or because people are in higher marginal tax brackets, tax expenditures automatically increase.

It therefore is misleading, in my view, to say that tax expenditures really are direct expenditures rather than being part of the basic tax structure.

Let me add one other feature.

The easiest way to get rid of the tax expenditure problem is to get rid of taxation; that is, if we were to drive tax revenues down to zero—that is, we would tax everybody at a zero marginal tax rate—we would then also have zero tax expenditures, not because we had made any explicit or direct changes in the tax expenditures.

All the tax expenditure provisions can be retained in the IRS code. However, we will have reduced them by making changes in the structural system.

This leads me to the conclusion that it is important to budget for tax expenditures but not to treat them precisely as if they were direct expenditures. I think that we are fortunate that the legislation before this committee, H.R. 4882, proceeds in this fashion because the main concern of this bill at this time is not whether we should make the exact same decisions for tax and direct spending.

I might point out something I neglected to say a moment ago. The two previous witnesses spoke about tradeoffs between that tax and direct expenditures, and they left out one very important consequence of those tradeoffs—the relative size of the public and private sectors.

If, in fact, we follow the procedure which Dr. Rivlin recommended and we allow authorizing committees to participate in legislating on tax expenditures—and we can expect them to favor direct spending rather than tax expenditures—what we will be doing to



build into our process is not zero increase in expenditures, which would seem to be what we are doing, because rather than have one form of expenditure that is direct, we would have another form, tax expenditure, we would be building in a process which would lead to the growth in the relative size of the public sector.

Every time you trade in a tax expenditure for a direct expenditure, you are increasing the relative size of the public sector. So for this reason, in addition to the others, I think it would be misleading to regard them both as functional equivalents.

What this bill does is to take the following position, if I understand it properly: whether or not we think tax and direct spending ought to be treated precisely the same way. Whenever we explicitly make a tax expenditure decision, we are making as well a decision with respect to the total revenues of the Federal Government.

Under the system of budget control that currently exists, we do not have adequate procedures to make decisions with respect to those totals.

As Mr. Cutter properly pointed out, if you simply make one decision with respect to one number, call it the total, we haven't controlled anything.

This year's tax expenditure legislation amply demonstrates the problem, proceeding on two separate tracks and spurred by a big war between Congress and the White House. What emerged was legislation which both reduced revenues by changing the basic tax structure and reduced revenues by inaugurating new tax expenditures.

These two tracks proceeded like parallel lines which were not brought together in the process, so at no time was there a decision as to what the total revenue loss should be from these two separate sets of considerations. I believe H.R. 4882 would lead to precisely that kind of consideration.

Let me conclude, however, by urging one area where I believe this legislation may be strengthened.

It turns out that most revenue losses are backloaded; that is, the brunt is felt in future years rather than in current years. So you have a system of 1 year at a time budget control. It could be that rather than effectively controlling the tax losses to the revenues, you allow them to escape through future year effective dates.

For example, the tax legislation which was enacted this summer has a zero loss from net interest deduction in fiscal year 1982; a projected loss of \$3 billion in fiscal year 1986, virtually no loss from the change in the rules with respect to charitable contributions in the current fiscal year; a \$2.5 billion loss a number of years from now; employee stockownership plans, no loss presently, over \$2 billion a couple of years from now.

We can go on down the roster and find that to control them 1 year at a time you actually give the affected committees a message—don't have the effective date in the year covered by the budget resolution, but have the effective date beginning after the expiration of the budget resolution and that will encourage a kind of evasion, which I am sure this legislation does not intend to facilitate.

So, I would urge and conclude with that suggestion with respect to strengthening the legislation.

Thank you.

[Mr. Schick's prepared statement follows:]



Statement of Allen Schick  
Before the  
House Committee on Rules  
December 9, 1981

Mr. Chairman, I am pleased to discuss proposed legislation to include tax expenditure ceilings in the congressional budget resolutions H.R. 4882, introduced by Rep. David E. Bonior, would amend the Congressional Budget Act to establish tax expenditure limits comparable to those already imposed on direct expenditures.

The timeliness of this proposal is demonstrated by the tax reduction legislation signed into law a few months ago. This summer, Santa gave taxpayers the biggest gift in American history, hundreds of billions of dollars of tax reduction. But as the real Christmas approached, Santa found that he had given away so much that he needed some of it back just to pay his bills. To make everybody feel good, these take-backs were labelled "enhancements", a term that leaves me expecting the next Christmas to come as early as April 1.

By now, the story of this year's debacle is well-known, but I'm not sure the lesson has been learned well enough to avoid a repetition of it. In a bidding war for legislative votes, the White House and Congress managed to cut basic tax rates while also approving huge expansions in tax expenditures. Tax reductions and tax expenditures moved through Congress without any process for forcing the committees of jurisdiction or the House and Senate to weigh the value of general tax relief against the claims for particular tax benefits. As a result, the federal budget is now in shambles, with escalating deficits likely in the coming years. Worse yet, the general and particular tax reductions seem timed to have maximum effect when the economy is likely to be expanding, a pro-cyclical accident that might mean resurgent interest rates in another year or two.

There is nothing in the rules of the House or Senate to prevent a recurrence of this year's misadventure that led Congress to pass and the President to sign a tax law that neither fully wanted. The legislation being considered by this Committee is intended to force Congress to decide tax expenditures in the context of overall budget policy.

#### The Tax Expenditure Concept

Tax expenditures are the revenues foregone by government because of deviations from its basic tax structure. For government, a tax expenditure is a loss in revenue; for taxpayers, it is a reduction in tax liability. The term suggests that revenue losses have expenditure and subsidy effects similar to those of direct expenditures. Some critics object to the term because (they argue) it connotes that all income belongs to the government unless it is returned in the form of tax expenditures. Others insist, however, that the term merely suggests that a government can pursue public objectives by foregoing revenues and that it therefore ought to regard tax expenditures as alternatives to direct expenditures.

Because a tax expenditure is a cost to it, a government can face the issue without tackling the ideological question. There are two basic issues: (1) What should be the aggregate revenues of the government? and, (2) should various objectives be pursued through tax incentives or direct payments? But it is important to note that tax and direct expenditures are not pure substitutes. They can lead to quite different distributions of costs and benefits. These differences, more than the evasion of budget controls, account for the widespread use of tax expenditures. If tax expenditures were to leave everybody no better or worse off than would direct expenditures, taxpayers would be indifferent as to the course taken by government. If they are not indifferent, it is because tax benefits promise a better deal than they expect to get from direct grants.

Budgeting for tax expenditures. In order for tax expenditures to be controlled, they have to be measured. However,

their measurement is much more problematical than that of direct expenditures. The problem begins with the definition of the basic tax structure. It is generally agreed that "structural" elements of a tax system should not be recorded as tax expenditures while "programmatic" features should be. Most tax subsidies do not pose any difficulty; they are intended for a particular social objective and can be readily classified as deviations from the normal structure.

Since tax expenditures are not actual outlays, the amounts "spent" are based on assumptions and estimates as to how taxpayers behave under particular conditions. The usual practice is to estimate the revenue loss of each tax expenditure separately, disregarding the interdependencies among the various provisions. The virtue of this approach is its simplicity; it is not necessary to consider the extent to which the availability of a particular tax expenditure affects the use of others by taxpayers. Moreover, this approach assumes that a retrenchment in tax expenditures would not be associated with changes in the basic structure, though for both political and economic reasons, this is not a tenable assumption.

Since the "cost" of any tax expenditure depends on the extent to which taxpayers avail themselves of the opportunities provided by the tax system, the estimates are based on assumptions about private behavior, not on firm appropriations. These assumptions tend to be grounded on past behavior and cannot always take into account the affects of changed incentives. The estimates are especially difficult to make when they apply to changes in tax policy--paradoxically, the situation in which they can be most valuable. For example, it appears that the revenue loss projected for the expanded IRA that takes effect January 1 will be wide of the mark because it was extrapolated from the older, more limited IRA.

Controlling tax expenditures. Tax expenditures are not as amenable to budget control as are direct expenditures. A comparison would help to illustrate the lack of control over tax expenditures.

Consider a government decision to assist industrial investment. One course of action would be to issue grants to firms that make the intended investments; another would be to reduce the tax liability of these firms. When it proceeds by direct grants, the government ordinarily formulates detailed rules setting forth eligibility criteria, application procedures, and other administrative requirements. If they are not convinced that the grant will be spent for appropriate purposes, government officials can reject the application or they can negotiate with applicants on the uses to which the funds would be put. They also can require periodic reports by grantees and can audit the investments to ensure that they are being properly made and administered. Control also comes through the appropriations process by means of which Congress can limit total spending for the program.

A tax incentive, by contrast, is likely to be open-ended with the amount spent depending as much on the interests and behavior of taxpayers as on direct government decisions. Firms normally would not have to apply for the benefits, nor would their expenditures be reviewed in advance by government officials. Tax incentives usually operate unilaterally, with taxpayers making their own determination as to whether they are eligible. While some of the tax returns would be audited, the odds are that most would escape serious review. Tax expenditures tend, in sum, to be encumbered by fewer administrative rules than are applied to direct expenditures. Government programs are often criticized for red tape, delay and cumbersome procedures; tax expenditures avoid these problems, but only because government control is weaker.

As a consequence, estimates of the cost of tax expenditures are notoriously unreliable. The recently-enacted leasing of depreciation benefits is a case in point. Because the cost of this new arrangement depends on the actions of eligible businesses, nobody could have foreseen the revenue losses that have ensued. As things have turned out, it now

appears that these losses will be many billions of dollars higher than the Treasury's estimates.

In assessing the impact of tax expenditures on budget control, one should be mindful of their implications for the tax structure as a whole. The proliferation of tax subsidies has complicated the tax system and has made it difficult for ordinary taxpayers to ascertain whether they are paying more or less than the law requires, and for tax officials to monitor compliance with the laws. In addition, these incentives have eroded the tax base and have compelled governments to levy high marginal rates in order to obtain needed revenues. Marginal rates could be significantly lowered if tax expenditures were curtailed without any loss in federal revenues.

#### Tax Expenditures and the Congressional Budget Process

The Congressional Budget Act of 1974 represented a breakthrough in the legal and political status of tax expenditures. Prior to the Act, tax expenditures were thought of in terms of loopholes and preferences, as practices to be railed against, but not as transactions subject to budget control. By defining tax expenditures in law, the Budget Act converted them into matters for legislative decision. Congress could decide on the level of tax expenditures or on the amount by which they should be reduced or increased each year. But the Budget Act stopped far short of imposing legislative control over tax expenditures. In the give and take that preceded enactment of the 1974 legislation, Congress substituted information for control. In lieu of limitations on tax expenditures comparable to those set for direct expenditures, Congress mandated the publication of data in the President's budget and in committee reports accompanying budget resolutions. However, these resolutions do not mention tax expenditures; they deal only with aggregate revenues and with dollar changes in the aggregates.

During the years that the congressional budget process has been in operation, the quality and availability of data on tax expenditures have been greatly improved. There now is a much clearer understanding of the types and extent of tax



subsidies and of their impact on the federal budget. Moreover, *specific tax expenditures now are linked with the particular budget functions with which they are associated.* This practice has made it possible to analyze tax and direct expenditures as substitutes for one another. Perhaps the most successful instance of this type of tradeoff analysis came in the late 1970's when Congress faced demands for increased federal assistance for college education. One proposal would have provided tax credits to help offset tuition payments; another would have made direct grants to low income students. There was a good possibility that both proposals would be enacted, causing a combined revenue loss and spending increase far in excess of what was budgeted. To avert this possibility, the budget committees juxtaposed the two proposals (which had been advanced by separate sets of committees) and showed that if both were enacted the cost to the treasury would be greater than the proponents of either proposal intended. This analysis contributed to rejection of the tuition tax credits.

But this type of success has been rare. For the most part, Congress has continued to legislate tax expenditures without direct budget control over its actions. The lack of functional categories for tax expenditures comparable to those used for direct spending means that Congress deals only with total revenues and this has proved to be an inadequate means of control. By manipulating the effective dates of new or expanded tax expenditures, Congress can approve revenue losses in excess of those intended by the budget resolutions but without violating the budget totals.

During the early years of the budget process, the Senate Budget Committee tried to establish the principle that budget resolutions could specify the amount by which revenues would be raised through "tax reform" -- a phrase which is taken to mean the curtailment of tax expenditures. This effort provoked open conflict between the Senate Budget and Finance Committees and eventuated in decisions favoring the Finance Committee's concept of budget resolutions limited

to total revenues. (Historically, tax expenditures have been a more difficult issue in the Senate than in the House, though this year's tax legislation diverged from the usual pattern.) The Senate Finance Committee has repeatedly signalled its willingness to adhere to the floor on total revenues set in budget resolutions, and on occasion (such as in 1978) these floors have constrained the enactment of new tax expenditures. However, consideration of tax expenditure legislation has not been significantly influenced by budget decisions.

Tax expenditures cannot be effectively controlled unless they are perceived by the public and by government officials as the functional equivalent of direct expenditures. Clearly, such is not the case at present. Most people and most congressmen regard tax expenditures as the retained income of taxpayers, not as a grant from government. It is understandable that they are not subjected to the same measure of control as is commonly applied to direct spending.

The congressional budget process has not put an end to increases in tax expenditures. During the 8 years since fiscal 1974, total tax expenditures (that is, the total of individual tax expenditures with adjustment for their interdependence) have spiralled approximately 250 percent, from \$75 billion to more than \$260 billion. Yet it would be misleading to conclude that this huge increase has been due to a failure in budget control. The bulk of the increase has occurred in old tax expenditures, not in ones enacted since 1974. The revenue loss from the deductibility of mortgage interest has increased by more than \$20 billion, the loss from the exclusion of employer pension contributions and medical insurance payments has swelled by more than \$35 billion. These losses grow automatically without legislative action because of two factors: (1) the amounts that can be deducted, excluded, or are given preferential treatment automatically rise under existing law. For example, when interest rates climb, homeowners are entitled to deduct larger amounts from their taxable income. (2) increases in tax burdens, especially in marginal tax rates. Tax rates are a function of

tax burdens. When tax rates are high, tax expenditures also tend to be high. The simplest way to curb tax expenditures would be to lower the basic rates. Conversely, when tax rates rise (whether because of economic growth, inflation, or discretionary policy) tax expenditures automatically rise.

#### Strengthening Budget Control Over Tax Expenditures

In my view, H.R. 4882 is a reasonable step in the extension of budget control to tax expenditures. It would not bar Congress from maintaining or increasing the level of tax expenditures, nor would it require that future reductions in federal revenues be made by lowering basic tax rates rather than by expanding tax subsidies. It would not require Congress to undertake social objectives by means of direct outlays rather than through tax policies. H.R. 4882 would permit Congress to make any revenue and tax expenditure decision approved by majority vote, provided that the decision was made in the context of the congressional budget. At all stages of the budget process, Congress would be made aware of the prospective impact of revenue legislation on total receipts and on tax expenditures. Further, Congress would expressly decide on the appropriate total of tax expenditures and on the amount, if any, by which the total would be changed.

If this arrangement were to work as intended, Congress might be able to avoid a repeat of this year's uncoordinated consideration of across-the-board tax relief and expansion of tax expenditures. Congress would be provided with data on the combined revenue loss and on how that loss compared with the amounts specified in the latest budget resolution. Congress could still proceed with revenue legislation at variance with the first budget resolution, just as it can with respect to direct expenditures, but at least it would be informed of the likely consequences of its actions.

It might be protested that the extension of budget control to tax expenditures cannot be effective because estimates of prospective tax losses often are unreliable. Furthermore, as I have already noted, the summing of individual tax expenditures

to produce a total is a questionable procedure. Yet the lack of data on actual--in contrast to estimated-- tax expenditures need not be an impediment to budget control. After all, the control of expenditures also hinges on estimates which often turn out to be wide of the mark. Anyone who participated in this year's reconciliation exercise knows that budget numbers are constantly changing and that what finally eventuates can be quite different from what was projected when the budget decisions were made. Any budget system operates under uncertainty and depends on estimates rather than on actuals for the simple reason that a budget deals with the future, not with the past. Two things are important for budget control to work: first, that the estimates be as reliable as possible and that they not be deliberately tampered with; second, that the participants in the budget process use a common set of estimates, so that they talk the same numbers when decisions are made.

In my view, revenue losses are a more useful basis of budget control than revenue totals are. The reason for this is that the totals are, for the most part, the result of past decisions and can oscillate rather widely with changes in economic conditions, while the losses are solely the product of current decisions. By controlling revenue losses-- those that ensue from general tax reduction and those from expanded tax expenditures-- Congress also controls the discretionary totals, those that are subject to its decisions. Moreover, if the budget resolutions set forth an amount of allowable revenue loss, budget debate would be more clearly focused on tax policy than if only the totals were specified.

Before concluding my statement, I feel it essential to bring one problem to the attention of the Committee because it can vitiate any effort to control tax expenditures. This year's tax reduction law "back loaded" many of the revenue changes, so that the bulk of the revenue losses will occur in future years, beyond the immediate control of current budget decisions. Some will take effect in the mid-1980's, after the 3-year span of the budget resolutions. For various reasons,

Section 303 of the Congressional Budget Act has not provided effective protection against this evasion of budget control. I would suggest that consideration be given to procedures that either would strengthen Section 303 protections or would ensure that budget decisions cover future revenue changes.

Mr. Chairman, H.R. 4882 is a rather modest and reasonable modification in budget practice. It relies on information rather than on sanctions and stops far short of other proposals for reining in tax expenditures. It does not tamper with the jurisdiction of congressional committees or with established legislative procedure. Some might argue that the measure is not tough enough, but I think otherwise. One should be wary of pushing the tax expenditure concept to the point where no distinction is made between direct spending and revenues foregone. The legislation before this Committee strikes a sensible balance; once experience is gained concerning the budget control of tax expenditures, Congress can explore whether it should take additional steps to tighten the controls.

Mr. DERRICK. Mr. Beilenson?

Mr. BEILENSEN. Thank you, Mr. Chairman.

I was worried for a while there, Professor, that you weren't for this procedure, but apparently you are supportive of Mr. Bonior's proposal.

Mr. SCHICK. Yes. I draw a distinction between two purposes.

One is to say direct and tax spending are to be treated alike for every aspect of Federal and congressional decisionmaking.

The other is to recognize that tax expenditures represent revenue losses to the Federal Government. These revenue losses affect the deficit. These revenue losses affect the condition of the economy and the capital markets, and Congress ought to take cognizance of these revenue losses through its budget apparatus.

Mr. BEILENSEN. Mr. Bonior's resolution does make that distinction.

Mr. SCHICK. That is right, I believe so.

Mr. BEILENSEN. Let me ask you just one sort of nonapropos question only because you are here, and I feel like asking it.

Do you happen to know if the \$750 million loss of revenues attributable to the 1981 Tax Act is based solely on the tax reduction features, or on those plus increases in the tax expenditures?

Mr. SCHICK. They are combined.

Mr. BEILENSEN. They are?

Mr. SCHICK. They are.



Mr. BEILENSEN. Will it be more than \$750 billion over 5 years?

Mr. SCHICK. It might be. We really don't know because some of the features haven't taken effect yet. Even those which have are just beginning to unfold.

Mr. BEILENSEN. Do you have any idea what fraction, what percentage of the overall \$750 billion loss of revenues can be attributed to the tax expenditure features of the bill?

Mr. SCHICK. It is a relatively small fraction, but as I, Dr. Rivlin and anyone in the budget field know, you are dealing with increments. You are dealing with more or less—

Mr. BEILENSEN. These stay in the code even if we do something else about the percentage decreases in the years to come, in the overall percentages?

Mr. SCHICK. If we look at the early projections from the Joint Committee on Taxation, we find, I would say, that probably 10 to 20 percent of the total revenue loss is due to tax expenditures.

Mr. FROST. If the gentleman will yield, there is an expiration date on at least one of these, on the all-savers, of course.

Mr. BEILENSEN. Thank you very much. Glad to have you on our side.

Mr. DERRICK. Mr. Frost?

Mr. FROST. I don't have any questions.

Mr. LONG. Mr. Bonior?

Mr. BONIOR. Doctor, thank you for your interesting testimony. I am glad to have you on our side, too.

I am interested in the issue that you address at the end, the manipulation of the tax expenditure issue so that it circumvents the current floors.

How would you deal with that problem in this legislation?

Mr. SCHICK. There are at least two ways that come to mind. One is to address the overall issue of multiyear budgeting so that you extend the budget process to the future years in a way that is more effective than the current extension. That is one path and would not relate expressly to direct expenditure, but to all features of budget control.

The other way is to reexamine section 303 of the Congressional Budget Act, which has as its original intention a prevention of this problem, section 303, which bars tax-spending decisions prior to adoption of a budget resolution, which was intended to avert this problem.

For various reasons, it turns out not to be an effective guard against manipulation of effective dates, so an alternative course of action would be to strengthen section 303 and its prohibitions.

Mr. BONIOR. In your testimony you testified that the aggregate estimates are not really that critical in their preciseness—and I agree with you—but I wonder if you could expand upon that a bit concerning how it would affect reconciliation.

Mr. SCHICK. Reconciliation is a perfect illustration of it. If you look at the reconciliation instructions which were transmitted to the various House and Senate committees this year, the instructions, which were the key to the budget control, did not deal with total spending. They dealt solely with changes in expenditure.

Committee X shall report legislation changing direct spending by a designated amount, so that all aspects of budget control work off

increments. I see no problem in applying this incremental concept, decremental, if you wish, to tax expenditures as well. It doesn't mean that you can't strike a total because clearly increments and decrements change the totals.

The approach I urge would be one which would avoid endless fighting over the accuracy of the totals. If you notice, I believe the chart put up here does not entirely conform to the numbers in the CBO report, which some of you have available.

There is a tremendous technical problem for which there is no solution; that is, if the sum is taken as the value of the individual tax expenditures, it will not take account of the interaction among the different tax expenditures.

Those interactions are real in the way taxpayers behave, so therefore in suggesting that you focus on the increments, the losses in tax revenues or gains in tax revenues, I am not saying that you cannot sum them up. I am saying that by focusing on its increments of the individual actions, you can sidestep some of the controversy which has afflicted tax expenditures thus far.

Mr. BONIOR. Thank you.

Mr. DERRICK. I will ask you the same question I asked the last two witnesses about the effect on the ability to plan in the business community. As you will recall in these hearings, that has been the big objection that we have had.

Mr. SCHICK. That is right.

Mr. DERRICK. And at least the reason given for nonsupport.

Mr. SCHICK. That is right.

Mr. DERRICK. And for not doing anything with tax expenditures.

Mr. SCHICK. It turns out, as Mr. Cutter pointed out, that most of the revenue losses from tax expenditures are in individual tax liabilities, not in corporate tax limits. As a matter of fact, of the total projected for fiscal year 1986, only about 15 percent of the total will be in corporate tax liabilities.

Consequently, we should not assume that if the objective is to substantially increase the revenues of the Federal Government by controlling tax expenditures through the budget process, that the easiest path to do it or the most productive one would be by changing features of the corporate tax laws.

I would admit that there probably would be some increase in uncertainty for businesses, but I would also suggest that given the changes which tax laws have experienced over the past decade, businesses have learned how to live with uncertainty.

Now, maybe because in some cases they benefited from it, but uncertainty is not new to the corporate world. It is not new with respect to many of the financial decisions that they have to make, and it is also not new with respect to the implications of tax policy to their decisions.

Mr. DERRICK. Thank you, Dr. Schick.

The committee will adjourn and reconvene at 2 p.m.

[Whereupon, at 12:25 the subcommittee recessed, to reconvene at 2 p.m., the same day.]

## AFTER RECESS

[The committee reconvened at 2:15 p.m., Hon. Claude Pepper, presiding.]

Mr. PEPPER. The committee will come to order.

We are holding hearings today on H.R. 4882, a matter within the original jurisdiction of this committee, to amend the Congressional Budget Act of 1974 to require that each congressional budget resolution fix the level of tax expenditures for the fiscal year involved, as well as the recommended level of Federal revenues.

We have had a number of witnesses already today. I believe according to the schedule, our next witness is Mr. Harry Havens, Assistant Comptroller General of the General Accounting Office.

Mr. Havens, we will be glad to hear from you.

**STATEMENT OF HARRY S. HAVENS, ASSISTANT COMPTROLLER  
GENERAL, GENERAL ACCOUNTING OFFICE**

Mr. HAVENS. Thank you, sir.

Mr. PEPPER. You know we think very highly, at least most of us do, about the General Accounting Office over here. It is an agency of the Congress, and we appreciate the valuable service you all render to the Congress.

Mr. HAVENS. I appreciate that very much, Mr. Pepper. I have a formal statement of about five pages which I would like to offer into the record.

Mr. PEPPER. Without objection, it will be received.

Mr. HAVENS. Partly because of much of the duplicate things that the committee has already heard, particularly in Dr. Rivlin's testimony this morning, I would like simply to summarize the main points and then proceed to respond to any questions you or the committee may have.

The first main point that we make is that tax expenditures do have economic effects and that tax expenditures should be considered as programs and should be analyzed in terms of effectiveness, efficiency and equity, just as direct spending programs are analyzed.

Second, tax expenditures are uncontrollable in the same way as entitlement programs; that is, the actual costs of tax expenditure programs depend on the actions and eligibility of other parties, individual private citizens, but as with entitlement programs, the costs of tax expenditures can be controlled through legislative action.

At present, the budget process controls tax expenditures only very indirectly, by setting a floor on net revenues.

The fourth point is that measuring tax expenditures is very difficult because of conceptual and technical problems which have been laid before the committee by several witnesses.

In our view, if Congress began using the estimates of tax expenditures seriously in the budget process, ways would be found to overcome these technical problems or to work around them in some fashion.

We believe the Congress should move in the direction of integrating tax expenditure decisions with the budget process but should move gradually in this direction. This would allow time to over-

come the technical problems and to work out the processes and relationships within the Congress that would be necessary to make that sort of a process work.

The other basic approach to integrating the review of tax expenditures with direct spending programs is represented by H.R. 58, the oversight reform sunset legislation being considered also by this committee. It would provide for review of tax expenditures by the committees responsible for oversight of the counterpart direct spending programs.

This approach would be useful, and we have endorsed it on several occasions, but I would have to say that the two approaches are not mutually exclusive. I would see it quite valuable over the long run to have both approaches to looking at tax expenditures, both in the budget process and in a systematic oversight reform process.

I think that covers the main points of my statement, and I would be happy to respond to any questions that you may have.

[Mr. Havens' prepared statement follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D. C. 20548

FOR RELEASE ON DELIVERY  
2:00 P.M.  
December 9, 1981

Statement of  
Harry S. Havens  
Assistant Comptroller General  
before the  
Committee on Rules  
House of Representatives

ON

Proposed Controls of Tax Expenditures

Mr. Chairman and Members of the Committee:

I welcome this opportunity to discuss the proposal for better controls over tax expenditures in H.R. 4882. As you requested, I will address the following four subjects:

- the nature and economic effect of tax expenditures;
- the relationship of tax expenditures to the Congressional budget process;
- the merits of setting annual ceilings in tax expenditures through budget resolutions; and
- alternative approaches to the control of tax expenditures.

THE NATURE AND ECONOMIC EFFECTS  
OF TAX EXPENDITURES

Tax expenditures which are sometimes referred to as tax subsidies, tax incentives, or tax preferences, are designed to grant tax relief to particular groups of taxpayers, in order to promote or subsidize certain private or business activities. The cost of a tax expenditure is the revenue the government does not collect because of the particular tax law provision.

There is controversy over whether some tax provisions are, in fact, correctly classified as tax expenditures. For example, some argue that mortgage and consumer interest deductions should not be treated as tax expenditures, because



a tax system that taxes interest income should also provide for a deduction of interest payments. The definitional problem aside, foregone revenues from tax expenditures are undoubtedly growing rapidly.

In thinking about this policy tool we need to consider whether they achieve their objectives efficiently or whether they generate unintended distortions in the allocation of resources. For example, in the case of the investment tax credit, which is intended to stimulate capital formation, increase labor productivity, and spur economic growth, we should ask if it merely subsidizes investment that would have occurred anyway. We should also ask if other policies such as direct Federal subsidies or loans would accomplish the same goals. Since the investment tax credit applies only to equipment, it distorts investment choices in favor of equipment. The distortion may induce suboptimal productivity and economic growth because the wrong types of assets are produced. The various tax expenditures subsidizing homeowners such as capital gains rollover and property tax deductions may have created incentives to overinvest in housing.

Tax expenditures must also be evaluated in terms of who receives the benefits. Tax expenditures embodied in individual income tax deductions benefit those in upper income brackets the most. The deduction allowed to individuals for casualty losses shows this affect. An individual in the top 50 percent marginal tax bracket pays only 50 cents for each eligible dollar of losses, while the individual in the 20 percent tax bracket pays 80 cents.

Tax expenditure levels may often be uncontrollable due to fluctuating economic conditions and legislative actions. Much of the recent growth in tax expenditures budgets has occurred because of inflation. Inflation affects the cost of tax expenditures not only by nominal growth in income and deductions, but also by "bracket creep." That is, as individuals move into higher tax brackets, the cost of tax expenditures rises. Changes in tax law also affect tax expenditures. The cross-the-board

reduction in marginal tax rates prescribed by the Economic Recovery Tax Act of 1981 significantly reduces the cost of tax expenditures. Other features of the 1981 Act such as accelerated cost recovery of assets, expanded individual retirement accounts, and all savers certificates will, of course, increase tax expenditures.

CURRENT RELATIONSHIP BETWEEN  
TAX EXPENDITURES AND THE  
CONGRESSIONAL BUDGET PROCESS

Deliberations in the early 1970s on the Congressional Budget Act considered whether to include tax expenditures in the congressional budgetary process, but the final legislation did not contain procedures for their control. Tax expenditures were regarded as legislative actions with relatively long-term effects, and hence not appropriate for an intensive annual budget review. However, the Act does require the President to submit tax expenditures information in his budget, and the Congressional Budget Office is also required to provide Congress with long-range estimates of tax expenditures.

The Budget Act controls only the net overall effect of tax expenditures. Congress does not set specific functional targets for tax expenditures in its budget resolution as it does for direct spending programs. Nor does it allocate target tax expenditure ceilings to its tax Committees. Tax expenditures, however, are subject to one important control. After the second budget resolution sets a floor on revenues, any legislation that would bring revenues below that floor is subject to a point of order. The consequence is that any increase in that expenditure must compete with all revenue-losing provisions for the amount of the tax reduction that is permitted.

There are currently problems with estimating tax expenditures. Given the difficulties they face, the U.S. Treasury Department, the Joint Committee on Taxation, and the Congressional Budget Office do an admirable job of preparing and presenting tax expenditures budget data.

The current tax expenditure estimates provide very useful information about how the Government affects society, but tax expenditure data are admittedly incomplete and contain some unre-

solved conceptual problems. To put the matter simply, techniques and procedures for estimating tax expenditures are quite new, and are by no means fully developed.

At present, estimates for each tax expenditure are made by assuming the removal of only the provisions of law that entitle individuals to the tax preference. This procedure brings into question the adding up of tax expenditure estimates into a total that could be used for control purposes, because the removal of two or more tax expenditures at the same time may have a different effect than their sum when considered separately. For example, if Congress repealed two or more itemized deductions, individual taxable income would increase. This might push some taxpayers into higher tax brackets, which would result in a greater cost of the remaining tax expenditures than originally estimated. In any event, the rise in tax rates would stop as soon as taxpayers realized that it was no longer advantageous to itemize deductions.

Moreover, in comparison to the number of people who develop data on spending programs, there are very few who are involved in preparing tax expenditure data. Stronger budgetary controls over tax expenditures should to be accompanied by the development and refinement of tax expenditure concepts and definitions, as well as more staff to gather and analyze tax expenditure information.

#### MERITS OF TAX EXPENDITURE CEILINGS

In our view, H.R. 4882 would have the effect of establishing binding ceilings on tax expenditures. Because of the inherent difficulties in estimating revenue losses, we are not convinced that such a requirement should be adopted at this time. We suggest, instead, that Congress take an evolutionary approach to strengthen its control over tax expenditures, starting with improvements in the information base and scorekeeping procedures, followed by the use of non-binding targets. The Congress took such an evolutionary approach, successfully, in gradually bringing Federal credit activities under more direct control through the budget process. While the technical problems are quite

difficult, we believe the same gradual approach would be appropriate in the case of tax expenditures.

ALTERNATIVES FOR CONTROLLING  
TAX EXPENDITURES

In addition to considering the possibility to tax expenditures controls through the budget process, Congress could also develop oversight procedures to compare tax expenditures with spending programs of similar purpose.

During the last Congress, this Committee, as well as others, thoroughly investigated several oversight reform proposals, including some that would have considered tax expenditures along with direct spending programs. Current versions of these proposals are now before this Congress. Although these proposals seek to join the review of tax expenditures with program authorization procedures rather than bringing these directly into the budget process, they would serve the purpose of strengthening oversight over tax expenditures. We have already indicated our support for the flexible approach contained in H.R. 58, which does provide for consideration of tax expenditures along with direct spending programs.

It would be possible to compare tax expenditures with spending programs more directly in the budget process. Budget committee reports could compare tax expenditures amounts with direct spending amounts in each budget function. Tax expenditures review could also be integrated with either the views and estimates process, or other aspects of congressional budget review.

I would also like to mention that we are now working to include tax expenditure information in our program inventory data base. Our tax expenditure file will be based on existing information sources, but we anticipate two major benefits. One, our inventory will bring together information that is currently dispersed in several publications. Two, our data will be automated, permitting more rapid and flexible comparison of tax expenditures with direct spending programs.

Mr. PEPPER. Mr. Bonior, would you like to ask questions?

Mr. BONIOR. Yes.

I thank you for coming, testifying, and giving us your expertise on this issue.

You mentioned or alluded to the question of definition. Could you expand upon that a little bit more? How would you correct the situation and where do you see the weaknesses in the definition of tax expenditures as outlined in the Budget Act?

Mr. HAVENS. One of the classic cases that is discussed from time to time is that of the deductibility of consumer interest as a tax expenditure. Some would argue that because we tax interest income we should provide a deduction for interest payment. I think you can make a rational argument on both sides of that.

I think the main issue in this sort of definitional problem is simply to agree on treating it one way or the other, either something is determined to be a tax expenditure or it is determined not to be. It is sort of like defining the boundaries of the Federal budget.

We have conventions by which we treat certain activities as within the budget. We have conventions by which we treat certain other activities which an arguable case could be made that they ought to be within the budget. Still, by convention, we have agreed not to include them in the budget.

I think you can do the same thing with tax expenditures. You look at some sort of a rational, dividing line between what represents a normal tax structure and what represents departures from that normal tax structure, and you draw that line, and you draw it in some sense arbitrarily, but in fact, once you have drawn the line, you can work with it, and that solves the problem.

Mr. BONIOR. In my statement earlier I quoted your 1979 GAO report, which stated that the cost of all tax expenditures is the difference between the revenue raised in the normal tax structure and that raised by the existing structure. In the real world, these costs cannot be determined directly.

I am just wondering if the problems cited there would be prohibitive to the legislation that I have introduced, H.R. 4882?

Mr. HAVENS. No; I don't think it would be prohibitive. I think again there clearly are technical measurement problems.

Mr. BONIOR. As there are with other things?

Mr. HAVENS. As there are with other things, the interaction among tax expenditures does create a conceptual measurement problem, but I think the solution to that is to develop conventions by which one will agree how to measure certain things.

You can agree that we will consider the cost of a particular tax expenditure to be the dollar value estimated to be associated with that particular activity, the amount of revenues that would be gained if that activity were eliminated or that particular tax expenditure, tax provision were eliminated, and everything else remained the same.

The problems arise when one begins to assume that other things don't remain the same, but just as in direct spending programs, when we analyze the effect of them, we frequently abstract from second order effects and from the interactions among programs and simply agree that that is how we will measure it.



Once you come into agreement as to how you will measure it and everybody measures in the same way, then you can have a reasonable debate on the effectiveness of the program, which is the real guts of the issue.

Mr. BONIOR. Your agency is often charged with the responsibility of ferreting out waste, fraud, and abuse, which has become a popular trilogy around this place lately.

In the tax expenditure part of our budget, the IRS is given main responsibility to substantiate claims on the Tax Code for those expenditures, and yet we know that, given their limitations of staff and, hence the ability to audit, in the largest percentage, by a long shot, tax returns are never audited—

Mr. HAVENS. That is correct.

Mr. BONIOR [continuing]. So the question I have, as you can well anticipate, is, What type of waste, fraud, and abuse control do we have through the tax expenditure system that we presently are operating under? Can there be any improvement made in that direction, and do you see this vehicle that I have proposed as a means of focusing on the issue, so that we can deal with not only the necessity of various tax expenditures, but the waste, fraud, and abuse that occurs therefrom?

Mr. HAVENS. I guess I would make a response in several facets to that.

First, I think IRS probably has a better handle than most agencies do of the extent of error in the program. They do have a fairly systematic sampling process by which they go back and reaudit returns taken at random and come up with what I think are quite credible estimates of how much fraud there is in the program and the degree to which they can detect it.

So in that sense I would say that the tax side of this sort of problem, we are probably more knowledgeable of the problems of fraud and abuse on that side than we are on many other programs.

Having said that, however, I think it is quite clear that with additional audit resources, the IRS could detect more and could recapture more. I don't have figures at the tip of my tongue, but from my years in OMB as a budget examiner, I know that IRS regularly estimates how much additional revenue you would have as a result of additional revenue agents and auditors. So I am sure IRS could in fact produce that sort of estimate.

In terms of what the effect of your proposal would be, Mr. Bonior, I think anything that causes greater attention to be given to tax expenditures as programs, and to be considered as programs, is likely to lead to greater attention being given to the efficient and effective management of those programs perceived as programs.

From that standpoint I think your bill, if enacted, probably would over the long run lead to greater attention in that area.

I won't see it as an immediate reaction, just like I am not sure that one would say going to an integrated budget process on the expenditure side led immediately to the sorts of concerns that now face us, but it certainly does contribute to it in the long run.

Mr. BONIOR. It is a step in that direction?

Mr. HAVENS. Yes, sir.

Mr. BONIOR. Thank you very much.

Mr. PEPPER. Mr. Derrick?

Mr. DERRICK. I think I will ask my standard question.

Do you see this as being a problem in the business sector—I realize that isn't the area you represent, but I would like your comments on it just the same—for planning, long-term planning?

This is what we have heard over the last couple of years. I think it probably has some basis.

Mr. HAVENS. Certainly anything one does that creates uncertainty creates a problem for the people who are placed in that condition of uncertainty. So if you put tax expenditures in the same category and review them with the same rigor and with the same possibility of changing that exists with direct spending programs, that certainly creates an element of uncertainty which was probably not present before, though I would have to say the tax expenditures have changed from time to time and therefore to some degree that uncertainty is already present.

Second, however, I would say that the business community is affected on both sides of the budget and that the uncertainty that exists on the spending side also affects business because businesses participate very actively in the things——

Mr. DERRICK. I gather they don't like it on the other side, either.

Mr. HAVENS. They probably don't, but I think uncertainty is to some degree a product of two things.

First, circumstances change and therefore Government policies must change to reflect all the circumstances.

Second, and this is a systemic problem that we have addressed, in fact, in conversations with you, Mr. Derrick, the failure of Government at present to think over a long enough time horizon, to plan its activities over a long enough period of time so that the problem of uncertainty is minimized.

The fact that tax expenditures are changing or might change or direct spending programs change or might change is much less of a problem if the people who are affected by that know far enough in advance to prepare for the change in circumstances.

So I don't think it is necessarily the fact of change that creates uncertainty, but the fact of unpredictable change, change which is not planned far enough for people to prepare for it.

Mr. DERRICK. Can you think of any corrections or changes we might make legislatively that would minimize this factor?

Mr. HAVENS. In the sense of minimizing the uncertainty, the recommendation that we have made—and we are not alone in that—is that the Government begin to budget on a much longer time horizon, with 3-, 4-, or 5-year planning horizons for the budget, which we are beginning to see with somewhat greater seriousness being attached to it over the last year or two, I think a very important move in that direction—and I would encourage that—and for it to become more and more of a serious exercise.

Mr. DERRICK. Thank you very much. I am always glad to have you appear before us.

Mr. HAVENS. It is always a pleasure to appear before you.

Mr. PEPPER. I didn't get a chance to hear the evidence this morning but I talked with Mr. Bonior about it a little bit ago. What you are basically talking about, calling it tax spending, is deductions by law; is that it? Or credit, tax credits, like you get credit on interest that you pay on mortgages or on a loan?

Mr. HAVENS. Those would all be examples of tax expenditures.  
Mr. PEPPER. Sort of like entitlements?

Mr. HAVENS. Yes. The conceptual definition of tax expenditures starts with the presumption that we have something that we would call a normal tax structure, which applies to everybody, which defines what your normal tax liability would be.

Then we have a whole series of departures totaling some 104 items, I believe, by CBO's current account, in which people who do certain things are allowed to reduce their tax liability, such as owning a house and therefore deducting mortgage interest or deducting State and local property taxes.

Mr. PEPPER. Tax shelters?

Mr. HAVENS. Tax shelters would fall under that too, yes, sir.

Mr. PEPPER. Heretofore, those things are sort of like topsy, they have just grown up, haven't they?

Mr. HAVENS. By and large that is correct.

Mr. PEPPER. They haven't been enacted on all at one time. They have been enacted here and there until finally we have the present accumulation?

Mr. HAVENS. That is a fair statement, yes, sir.

Mr. PEPPER. This Budget Committee authority would be to take a look at all of these things to see if they want to withdraw any or at least if they are going to keep them, they put it into a figure so everybody would know how much it is.

Mr. HAVENS. That, and I would add the additional important ingredient of looking not only at the tax expenditure for a particular activity, but contrasting that with the direct spending program. For example, we have got mortgage interest deductions for housing in the tax expenditure budget, and the whole series of other housing subsidies there, and we have housing subsidies on the direct spending side.

Mr. PEPPER. Let's just take the containment resolutions that were adopted earlier, the Gramm-Latta resolution. They cut them, the expenditure curtailment?

Mr. HAVENS. The Reconciliation Act.

Mr. PEPPER. The Gramm-Latta resolution. In those instances could you tell us how much the total tax expenditure was in that series or in those resolutions?

Mr. HAVENS. I would have to defer to CBO's estimates of what they were, and the figure of \$266 billion, I believe, was the 1982—

Mr. BONIOR. \$229 billion previously.

Mr. HAVENS. \$229 billion in 1981, yes. I would have no reason to dispute those figures.

Mr. PEPPER. This was a direct tax, they lowered the rates from 70 percent down to 50 percent?

Mr. HAVENS. Yes; and that would not be a tax expenditure.

Mr. PEPPER. And they lowered the rate for capital gains?

Mr. HAVENS. Yes.

Mr. PEPPER. And then, of course, they reduced the rates on taxes generally, income taxes, but in addition to that, they gave many tax credits, didn't they?

Mr. HAVENS. Yes.

Mr. PEPPER. Do you know, Mr. Bonior, how much that was?

Mr. BONIOR. Yes. They expanded 22 existing tax expenditures; they added 8 new ones, and they repealed 2 in the last tax bill.

Mr. PEPPER. Do you know about what the total tax expenditure was?

Mr. BONIOR. The total cost on all of those?

Mr. PEPPER. Yes.

Mr. BONIOR. I have been told it is \$75 billion over 5 years.

Mr. PEPPER. \$75 billion?

Mr. BONIOR. Yes; and the most famous one that we hear a lot about now is the so-called sale-leaseback provision on the investment tax credit. That is where the corporations are selling their investment tax credits.

Mr. PEPPER. Is that included in the \$75 billion?

Mr. CHAMPLIN. No, sir, it isn't, because by a typo error that wasn't put in the CBO charts. Nobody really knows how many billion to include because of the lease provision on top of the \$75 billion.

Mr. PEPPER. Who can give the approximate figures on how much the total was? What the total tax expenditure was in those?

Mr. BONIOR. We can get that for you.

Mr. PEPPER. Would somebody be good enough to get it? I would like to see what it would amount to.

Mr. HAVENS. I think CBO would be the best source of that data. We would be happy to let them know of your request and be sure that they do supply it for you.

Mr. PEPPER. Are there any other questions?

Thank you very much, Mr. Havens. We appreciate your coming.

Mr. HAVENS. Thank you, Mr. Pepper.

Mr. PEPPER. We have 6 minutes left. We have another witness here, Mr. Ray Denison. Maybe we had better run down and vote and then come back. We will run down and vote and come right back.

[A brief recess was taken.]

Mr. PEPPER. The committee will come to order, please. Our next witness is Mr. Ray Denison, Director of the Department of Legislation, American Federation of Labor—the Congress of Industrial Organizations.

We are pleased to have you, Mr. Denison, and we welcome your statement.

**STATEMENT OF RAY DENISON, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR-CONGRESS OF INDUSTRIAL ORGANIZATIONS, ACCOMPANIED BY ARNOLD CANTOR, ASSISTANT DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH**

Mr. DENISON. Thank you. I am accompanied this afternoon by Arnold Cantor, who is the Assistant Director of our Department of Economic Policy.

Mr. PEPPER. We are pleased to have you. Do you have a statement?

Mr. DENISON. Yes; I have a prepared statement.

Mr. PEPPER. You may read it or put it in the record and summarize it.



Mr. DENISON. If I may, I would like to read the statement. It is not too long.

Mr. PEPPER. We would be pleased to hear you.

Mr. DENISON. It does express the position of the AFL-CIO and its affiliated organizations.

The AFL-CIO is pleased to present its views on tax expenditures generally, and H.R. 4882, which would amend the Budget Act of 1974, by mandating the inclusion of tax expenditure levels in each of the concurrent resolutions on the budget.

Tax expenditures are costs to the Treasury and the Nation's taxpayers. Like any other expenditure they add to the deficit, affect the level of funds available for other outlays, lending activities, debt reduction or general tax cuts and they serve to redirect resources to particular sectors, groups or activities.

Some major differences, however, are that tax expenditures tend to be subjected to few of the standards of performance, accountability and oversight that apply to spending programs; rarely are they enacted as a result of reliable evidence of need or likelihood of fulfilling expectations and in the main they represent open-ended "entitlements" over which Congress has little control.

And, as important, although tax expenditures are not necessarily synonymous with tax loopholes, most of the costly and inequitable provisions in the tax code are included in the expenditure budget.

Expenditures through the tax code have grown dramatically. They have far outstripped the growth in direct spending and there seems to be no letup in the array and variety of tax forgiveness devices being proposed as a means to solve virtually every identifiable problem. In fact, as the likelihood of additional appropriations for new or expanded programs becomes more difficult, the temptation and pressure to use the tax expenditure route increases.

This excessive reliance upon tax forgiveness has resulted in a Federal tax structure that is an affront to fundamental principles of taxation based on the ability to pay. It has severely and unnecessarily limited the Nation's ability to solve its growing economic and social problems, and we are also convinced that the tax cuts and tax expenditures enacted last August are a major part of today's rapidly spreading economic mess.

The first tax expenditure budget, in 1967, reported a total of \$37 billion in revenue foregone. The list for fiscal year 1982 totals \$276 billion, according to the current Federal budget "Special Analysis." This represents a growth rate over the past 15 years, 33 percent faster than the much maligned growth in direct budget outlays.

The 1967 tax expenditure listing contained 50 items and in the listing for 1982, published last January, 104 items were cited. The Economic Recovery Tax Act brought the total number up to 110, expanded 22 of the already existing tax expenditures, and added \$12 billion to fiscal year 1982 tax expenditures. These estimates, incidentally, were made long before it became apparent that certain of the provisions—"all savers" and safe-harbor leasing particularly, were going to cost far more than anticipated.

The tax expenditure concept serves a dual purpose. It is an attempt to measure the money that the Federal Government is not collecting as a result of special provisions in the tax law which in general have been enacted as a means to encourage a particular



kind of activity or aid a particular category of taxpayer and an effort to relate tax expenditures with direct outlays according to budgetary functional category.

The Budget Act defines tax expenditures as: “\* \* \* those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”

Under that definition, provisions which are considered an integral part of the normal structure such as the rate schedules, personal exemptions, and allowable deductions for costs of earning taxable income are not tax expenditures, and only certain special provisions of the Tax Code that are considered to have a purpose beyond simply defining and measuring taxpayers' taxable net income fall into the tax expenditure category.

Thus, in the Economic Recovery Tax Act of 1981 for example, the basic 3-year 5 percent, 10 percent, 10 percent rate cut is not included as a tax expenditure, despite the fact that higher income groups are the major beneficiaries. The array of special provisions for corporations such as the depreciation writeoffs and the tax breaks for higher income savers do fall under this definition.

Although identifying and categorizing provisions in that fashion does not imply a judgment on the merits of the particular provision, the fact is that most every loophole in the tax structure also fits within that definition. The tax expenditure listing, therefore, highlights most of the major inequities in the tax structure and their cost. The Tax Expenditure Budget does not, however, include one of the most serious loopholes—the foreign tax credit—nor does the budget go beyond the corporate and individual income tax to include estate and gift taxes, excise and Federal employment taxes.

Tax expenditures also follow the functional categories of the Federal budget and in that fashion an attempt is made to shed more light on the relationship between the direct expenditures and tax expenditures in each functional category.

Currently, the Budget Act requires No. 1, 5-year projections of the estimated levels of tax expenditures be included in the Budget Committee reports accompanying the first concurrent resolution and No. 2, committee reports on all bills providing for new or increased tax expenditures include 5-year revenue loss estimates.

Although the resolutions do not set either overall or functional targets for tax expenditures a revenue floor is set in the second resolution and any legislation, including tax expenditures, that would reduce total revenue can be ruled out of order.

In addition, all revenue-reducing bills—general tax reductions and tax expenditure increases—must compete within the same level of overall tax reduction provided in the resolution and therefore a reasonably powerful constraint on the aggregate level of tax expenditures does exist in the congressional budget process.

H.R. 4882 attempts to strengthen the existing budgetary tax expenditure constraint through requiring congressional action on a specific aggregate level of tax expenditures in addition to revenue levels in both resolutions, and the resolution would direct the tax-writing committees to meet specific and separate targets of revenues and tax expenditures.

Mr. Chairman, it is rather obvious that H.R. 4882 was triggered by concern over the rapid growth in tax expenditures, and the damage that is being done to the tax structure, and the economy as a result.

We share the concerns and certainly agree that curbing the growth of tax expenditures is an appropriate objective. And we feel that the tax expenditure budget is an extremely valuable tool and guide for policy and decisionmaking.

We do feel, however, that there are a number of conceptual measurement and classification problems that must first be solved before the concept is given such statutory weight and significance. And in our judgment, until such problems are solved, the budget process would become even more cumbersome, subjective, and manipulatable if it contained such ceilings.

For example, it is commonly acknowledged that arithmetic totals of tax expenditures are of very limited significance since there is such a variety of interactions and interdependency between tax provisions. For example, legislation that increases personal exemptions or reduces rates generally serves to lower tax expenditures since lower overall taxes mean that a special preference is less costly.

The competition within the tax expenditure budget would probably be heightened as would conflicts between tax expenditures and direct programs within particular budget program categories. The outcome could be more inequities and greater reliance on tax forgiveness. For example, Congress could find itself in a position of being forced to trade off homeowners' deductions for corporate depreciation writeoff within the tax expenditure budget or trade employment tax credits for vocational education programs within the functional category which encompasses Federal spending programs on education, training, employment, and social services.

And, of course, there is still a good deal of controversy over what is to be considered a tax expenditure. It is our understanding, for example, that there is a considerable difference of opinion as to whether or not the recently enacted reductions in the marriage penalty should be considered as tax expenditures—an item which, incidentally, amounts to \$4.4 billion in fiscal year 1983.

We are also concerned that limiting the level or growth rate of expenditures could be interpreted as tax reform. That does not necessarily follow. The tax expenditure budget includes huge, costly and glaring abuses such as the 60 percent of capital gains exclusion loophole and the new business depreciation system. Also included are the costs of providing additional personal exemptions for the blind and a large group of other provisions which rightly or wrongly have long established constituencies and might, within the context of a perfect tax system or a major comprehensive effort at reform, be repealable or reduceable, but certainly could or should not be changed in isolation—or more to the point, within the context of the budget reconciliation process.

I would like to emphasize, however, that we do feel efforts to give the tax expenditure budget more prominence and visibility should go forward and we would be happy to support such efforts.

We would, for example, suggest that each tax expenditure budget include estimates of the distribution of items by income class, in

the case of individuals and asset size for business tax expenditures. This is presently done on only an ad hoc basis and is not included in the Federal budget or the Congressional Budget Office reports. We feel that better and more timely information on beneficiaries of particular tax expenditures and their needs would improve tax policy and help to curb tax expenditure growth.

We would also like to see frequent—annual, if possible—data on the costs and benefits of major tax expenditures that have been justified and enacted as incentives to encourage a particular activity. Such analysis should, for example, provide some insights as to the effects of the new depreciation system on investment, productivity and job creation, the impact of the interest income exclusions on the level of savings, as well as the costs and effects of the various tax provisions that subsidize the global activities of U.S. multinational corporations.

Mr. Chairman, the AFL-CIO has consistently been at the forefront of the fight for a just tax structure. The attached resolutions adopted by the 14th convention last month detail our positions on tax justice and also spell out our recommendations for dealing with the present recession.

An important byproduct of these recommendations would be to substantially cut back on the overall level of tax expenditures and to put into effect and fund specific programs that can be targeted and tailored to the Nation's needs.

Thank you.

[The resolutions referred to by Mr. Denison follow:]

## Tax Justice

The Reagan tax cut has rigged the tax structure against working people and overloaded it with tax avoidance opportunities for corporations and the wealthy.

Unless this course is reversed the economic and social problems that are the inevitable result of shoe-string public budgets financed by unfair taxes will fester and grow. Hundreds of billions of dollars that should be creating jobs, revitalizing and rebuilding the nation's cities, industries and distressed areas, meeting the needs of the poor, the old and the moderate and middle-income Americans will be siphoned off by the rich and the corporations.

Tax justice now requires a massive overhaul of the tax structure. The adverse consequences of the Reagan program must be averted and the damage done over the past decade must be repaired. Efforts already underway to shift more of the burden on working people through tax cuts masquerading as devices to meet urban problems (Urban Enterprise Zones), improve educational opportunities (Tuition Tax Credits), and the like must be rejected and new taxes, such as value-added tax or other inequitable consumption taxes must be fought.

The Reagan tax cut represents an unprecedented and dangerous gamble with the nation's future. Between now and 1986 some \$750 billion in revenues will be lost and approximately half of that amount will go to businesses and the wealthiest 5 to 10 percent of the population.

By 1986, the effective tax rate on corporate income will be cut in half, the corporate income tax, will account for only 14 percent of federal income tax receipts compared to 21 percent currently and 27 percent a decade ago. In terms of the total budget the corporate share will plunge to only 8 percent compared to 12 percent now and 17 percent a decade ago.

The Reagan tax cut was merchandized as a tool to fight inflation, reduce unemployment and promote productive investment. We believe it will do just the opposite. Top priority must be given to assure this massive and inequitable shift of the nation's resources does not do irreparable damage.

We therefore call upon the Congress to carefully monitor the course of the economy and the effects of the tax program and develop an alternative program which could be put into effect quickly.

Particular attention should be focused on the income tax cuts scheduled to take place in future years and the business tax cuts effect on distorting investment, promoting mergers, takeovers, plant migration, overseas investments and speculative ventures that add to the nation's economic problems and dissipate the funds needed to deal with them.



The elements of such a program should include:

- A substantial restructuring of the individual income tax cuts scheduled for 1983 and 1984 and the indexation provisions in a fashion which curbs revenue losses and limits relief to the moderate and middle income taxpayers who were so dramatically short-changed by the 1981 Act.

- Repeal of the 10 percent Investment Tax Credit and enactment of a business depreciation system which permits an accurate accounting of business costs and income for tax purposes.

- Enactment of a reindustrialization program which would be empowered—through a tripartite business, labor and government board—to use business tax incentives, grants, loans and other aids in a fashion which carefully and precisely targets available funds to revitalize the nation's distressed areas and industrial base.

Tax justice, however requires much more than redressing the inequities of the Reagan program. The AFL-CIO reaffirms its support for a far reaching program of loophole closing and basic reform that will put an end to the provisions which rig the tax

structure against working people and assures a public sector adequately equipped to deal with the economic, social and defense needs of the nation.

The AFL-CIO therefore will continue to press for the full range of measures which are necessary to:

- End the preferential double-standard which taxes workers' wages and salaries at far higher rates than "unearned income" on the savings, investments and estates of the wealthy.

- Reinstate the corporate income tax as a source of revenue and equity and eliminate the so-called "incentives" that subsidize mergers, takeovers, plant shut-downs, overseas investments and other activities that conflict with the national interest.

- Provide a basic structure of credits, exemptions, deductions and graduated rates which fully reflect the principal of ability-to-pay.



## The National Economy

The hollow promises of the Reagan Economic Program are a smokescreen to conceal a massive transfer of wealth and income away from workers, away from low- and middle-income Americans, to the pockets of the wealthy and the profits of big corporations.

The blatant policies of the Reagan Administration are threatening the jobs and the living standards of America's working men and women and endangering the sense of fair play and social justice that binds and unifies America.

These Reagan Administration policies add up to class warfare against the disadvantaged, the poor and the working people of America. They will put more people out of work and aggravate inflation. They will add to inequity, unfairness and divisiveness. These policies must be exposed, the damage minimized and the course reversed.

The AFL-CIO repeats its strong support for the proposition that inflation must be reduced, the unemployed put back to work, productivity and industrial strength restored, and federal programs made more effective and efficient. We do not agree with the economic program spelled out by the Reagan Administration and embraced by Congress in 1981 for it will not meet these objectives.

The Reagan economic program requires more sacrifice from those who have little, to give to those who already have much. It substitutes unrestrained market power for social responsibility and human concerns. It shortchanges sound economic growth by cutting back programs to achieve energy independence, rebuild the nation's transportation system, revitalize urban areas, and safeguard the environment.

The key elements of the Reagan Administration's program—huge cuts in federal spending and taxes—are now on the books.

We believe Congress and the nation must be prepared for drastic action in the likely event that the Reagan economic program does not work—that it fails to lift the American economy out of recessionary high unemployment and fails to reduce inflation. If the present unemployment-inflation-high interest rate conditions continue, there must be prompt action to reverse the direction of economic policy and adopt policies that deal effectively and fairly with the causes of inflation and the hardship of unemployment.

Such policies must base any sharing of austerity in the fight on inflation on the ability to sacrifice and must not demand even more sacrifice from those who know only austerity. They must also include adequate resources to provide needed investment in specific industrial and geographic sectors within an overall employment program.

The basic principles behind the economic policies supported by the AFL-CIO are simple:

- We believe that economic progress and social justice go together. Fairness and compassion are not in conflict with efficiency.

Fair income distribution must be a major concern of economic policy. In practical terms this means a level of wages and incomes and taxes for America's workers and consumers that provide a sound basis for a balanced expanding U.S. economy with high-volume, cost-cutting mass production of the goods and services America's people need and want for a rising standard of living. Thus, unions and collective bargaining make an important contribution to America's social and economic progress.

Furthermore, basic social programs that help people who are unemployed, aged, weak, or helpless, are fundamental to economic progress as well as social goals. These programs maintain income and thus maintain consumer buying power which gives stability and resilience to the American economy. They must be strengthened and improved not destroyed or weakened.

- We believe full employment is a moral, social, political and economic imperative.

Unemployment generates immeasurable social losses which include physical and mental illness, family disorganization, social alienation and crime. For every one million jobless workers America loses at least \$100 billion of goods and services.

The commitment to full employment set forth in the Humphrey-Hawkins Full Employment and Balanced Economic Growth Act of 1978 must be fulfilled.

- We believe the attack against inflation must focus on the true causes of inflation, on the specific sectors of energy, food, health care, and housing, and high interest rates.

Inflation in America today, is not caused by excessive government spending nor can it be halted by cutting basic social programs and loading hardship on the weak and defenseless and tax breaks and tax loopholes on the rich. The tight monetary-high interest rate policies are aggravating inflation rather than curing it.

- We believe the nation's economic growth and productivity must be raised by a comprehensive reindustrialization program including effective employment and training programs.

Business, labor and government should participate in an economic program of reindustrialization and development to strengthen America by helping to channel private and public investment to modernize basic and essential industries and public capital facilities, to revitalize lagging geographic areas, generate jobs, growth and price stability.

- We believe this nation's international trade and investment policies must give much more weight to U.S. interests.

Exports and imports account for 25 to 30 percent of the U.S. output of goods. Foreign investment in the U.S. is growing. U.S. multinational firms are exporting capital, technology, production and jobs, and foreign imports compete unfairly in the U.S. market, undermining this nation's industrial base, weakening the U.S. competitive position in world trade, and jeopardizing U.S. national security.

The U.S. must deal effectively with the adverse effects of international trade and finances on U.S. workers, on U.S. industries, and on U.S. national security.

The AFL-CIO sets forth the following national economic program, to fulfill these principles—as both a long-term objective and to provide the components for an interim, stand-by economic program:

#### I. Social Justice

Fair and reasonable income distribution must be a major concern of general economic policy and tax policy. Basic income support programs for the unemployed, the poor and the elderly must be maintained and improved. Further efforts by the Administration to destroy or weaken these programs through the budget process must be rejected.

Congress must block efforts to dismantle or weaken federal regulatory agencies and federal laws and regulations which were established to protect consumers and workers and the general public from unfair, monopolistic, and anti-social business practices.

The AFL-CIO continues to support a strong national defense—not as a source of jobs but as a necessary precondition to the survival of democratic institutions—but our support does not mean a blank check for the Pentagon. Military strength depends on having appropriate weapons, ready manpower, logistical support and intelligent strategy.

Vast increases in defense spending will not in themselves necessarily strengthen the U.S. defense posture. The key issue is what these dollars buy and how well they meet U.S. security needs. By increasing defense spending at the expense of vital social programs, the Reagan Administration risks a loss of support and creation of anti-defense constituencies among workers, the poor, minorities, and the elderly, which could jeopardize the nation.

To stimulate economic progress and economic equity, workers must have an increased share in the benefits of economic progress. A balanced economy requires a fair and productive tax structure and adequate growth of consumer markets which depend on adequate growth of consumer buying power. The needed level and diversity in consumer spending cannot be achieved unless increases in workers' real income are achieved.

## II. Jobs and Training

Job and training opportunities must be made available for unemployed men and women who cannot find jobs in the private sector through direct, targeted and adequately funded public employment programs.

The unemployed should have the opportunity to work on public service and public investment projects that expand services and facilities needed for a healthy economy and they should get training in skills that are in short supply. These programs can be targeted to increase supply and economic efficiency in key areas, thereby moderating prices, while reducing unemployment.

There should be more targeted job training opportunities for adult workers including women and minorities and other groups with special needs, and special programs for youth. Training programs should provide new job skills and lead to job opportunities.

We support private sector training, including on-the-job training and upgrading and apprenticeship programs. At the same time we oppose wage subsidies to private employers—whether done directly through public grants or through the back door of tax cuts. Private sector training programs supported by federal funds must have federal safeguards and standards of performance, in order to avoid abuse, exploitation, and undercutting of wage standards and worker protections.

## III. Anti-Inflation Policies

The fight against inflation must attack directly the problem areas of high interest rates, energy, housing, food and health care. Budget cuts frequently aggravate inflationary pressures in these sectors.

To lower high interest rates—Lower borrowing costs are necessary to encourage expansion of the housing industry, investment in productive plant and equipment, and state and local public investment.

Funds and credit should be selectively controlled and targeted for productive industrial development and needed housing expansion. Existing credit control authority should be used and new tools developed to channel available credit to productive use.



To reduce inflation in energy—Reducing inflation in energy requires maintaining controls on natural gas, continuing authority to control oil prices and rationing in time of need. Expansion, development and use of alternative sources of energy is essential as are reformed utility rate structures and expanded conservation programs.

A U.S. oil import agency should be empowered to purchase and distribute oil imports, thus assuring the nation an adequate supply of oil at a fair price.

To reduce inflation in housing—Curbing inflation in housing requires funding government programs that help increase the supply of low- and middle-income housing, wider use of below-market interest rate mortgages for low- and middle-income buyers, and deterrents to the conversion of rental housing structures to condominiums in tight housing markets.

Home mortgage financing by union pension funds invested in long-term fixed-payment mortgages guaranteed by the government should be encouraged.

To reduce inflation in food—Restrictions should be placed on export of commodities in short supply. A National Grain Board similar to the Canadian Wheat Board should be established to handle foreign sales of U.S. grain. Price support programs should be limited to small- and moderate-sized farms.

To reduce inflation in health care—Health Maintenance Organizations, should be expanded and there should be encouragement of the use of cost-reducing practices, such as second opinions before elective surgery and support for healthy planning to eliminate duplication of costly equipment and services. The entire health care system should be reformed through national health insurance.

#### IV. Rebuilding the U.S. Economy

To modernize and revitalize the American economy, business, labor and government should participate in a tripartite Reindustrialization Board. Under this board, a Reconstruction Finance Corporation would invest public and private funds in necessary reindustrialization projects.

The RFC should have authority to use loans, loan guarantees, targeted tax incentives and other tools to encourage new industries that have difficulty obtaining necessary financing, and assist older industries with special capital needs for modernization, expansion and restoration of their competitive position. The RFC should also direct its resources to specific geographic areas of the country that are most in need.



The urban infrastructure of sewers, water systems, streets and bridges needs to be renewed and the nation's transportation network must be upgraded for people and goods to move more efficiently. Railroad, highways, port facilities and airports are in desperate need of rehabilitation. Urban mass transit systems need support and modernization.

There should be a thorough monitoring, review and analysis of the existing and newly enacted business tax "incentives" in the light of reindustrialization goals. The huge and costly array of provisions that have been enacted as "incentives" to investment must conform with reindustrialization goals and tax justice.

#### V. Economic Concentration

Big corporations and big financial institutions are rapidly increasing their influence and power over the welfare of workers, the interests of taxpayers and citizens, and America's basic economic, political, and social goals. Corporate power must serve the public interest and corporate misconduct must be brought under control. A wide range of reform is necessary, including:

Effective enforcement of anti-trust laws, federal chartering of major corporations; prohibiting huge conglomerate mergers; prohibiting interlocking directors; setting triple damage compensation for all victims of corporate price-fixing including secondary customers; legislating stronger penalties for consumer fraud and price-fixing by corporate officials; protecting privacy rights against lie detectors and other invasions of privacy; checking media concentration; and establishing more control on big oil company investments in competing energy sources, and in other non-oil investments.

#### VI. International Trade

International trade and investment policies must emphasize U.S. welfare and national security, including specifically the welfare of American workers, local communities, and key industries.

A wide range of specific actions is needed to deal with this nation's international trade and investment concerns, including the erosion of the nation's industrial base and maintaining and improving trade adjustment assistance to assure that workers injured by imports get prompt aid and adjustment help.

The AFL-CIO will continue to work for the programs and policies that will provide jobs for all Americans who want to work, win the fight against inflation, assure a rising standard of living for all Americans, and bring about a more equitable sharing of the nation's income and wealth.

## VII. Anti-Recession Program

Like a snowball rolling downhill, the economic recession is gaining momentum. Unemployment has increased by one million in the past three months and each day thousands more are being laid off.

But the Reagan Administration response to rising unemployment is to resurrect Herbert Hoover's economic policies of 50 years ago with additional budget cuts that will further weaken demand, reduce output, and destroy more jobs.

The resulting weakened economy would be even more costly and damaging to the nation in terms of lost production, lost jobs, lost skills, and lost income to producers and workers.

The tragedy of unemployment and the steadily worsening economic situation must be reversed.

The AFL-CIO calls upon the Congress to pass the following anti-recession, job-creating programs:

A. Programs already on the books must be given sufficient funding to provide jobs rapidly and help lift the economy, specifically:

- Revive the emergency local public works program;
- Provide new low- and middle-income housing units;
- Restore public service jobs for workers not able to find jobs;
- Restore nationwide extended unemployment compensation benefits to protect the long-term unemployed.

B. Stimulate the economy with new legislation, specifically:

- Establish a Reconstruction Finance Corporation to revitalize the economy with loans, loan guarantees, interest rate subsidies and targeted tax benefits for retooling and growth of basic industries with special consideration for high unemployment areas;
- Place temporary restrictions on harmful imports to prevent added penetration of U.S. markets by foreign producers and further weakening of the nation's industrial base.

C. Use credit control authority to offset tight money policy and excessive interest rates and to channel funds into productive uses, including housing, and to stop unproductive credit

flows that aggravate the economic situation with speculative excesses and merger activities.

D. Raise revenue for these programs and restore equity by:

\* Limiting the individual income tax cuts for 1982 to \$700 per taxpayer, roughly the amount scheduled for those with incomes of \$40,000;

\* Cutting the 10 percent investment tax credit back to its original 7 percent level to preclude subsidizing the same firms and investments as does the huge newly enacted depreciation system;

\* Withdrawing oil windfall profits tax give-aways to wealthy oil royalty owners in the 1981 Reagan Tax Act.

Mr. PEPPER. Would you like to add anything to what Mr. Denison has said?

Mr. CANTOR. No, sir; I will just be available.

Mr. PEPPER. Mr. Bonior, would you like to ask questions?

Mr. BONIOR. Yes; I thank you for coming and testifying. I just want to let you know how enthusiastic I was about your statement. But, I am somewhat puzzled on one point.

You seem to have a very thorough knowledge and understanding of the whole problem, and I am somewhat puzzled by your lack of enthusiasm for the solution at hand. I guess I am puzzled because it seems to me that what we have done in this Congress, and what we will probably do in succeeding Congresses if we don't address this problem through the budget process, is to deal with about 30 percent of the budget. The rest of it is going to be out of our control, and that 30 percent is the area in which you and I have been literally getting licked on.

It seems to me that if we are going to try to balance the equation, we have to develop a confrontation between direct expenditures and tax expenditures—which by the way are primarily to the advantage of those people in the upper income brackets, those who make \$50,000 or more. They get a substantial amount of these tax expenditures, and I could go through a litany of percentages of those specific functions in which they come out very well.

You said, "The competition within the tax expenditure budget would probably be heightened, as would conflicts between tax expenditures and direct programs within particular budget program categories." [See par. 5, pg. 190.]

You know that would be my hope, that we would have to deal with a situation between cutting back on feeding programs for children and giving Burlington Northern, who with \$223 million in profits last year, made an extra \$33 million because of the lease-back provision. You say, "The outcome could be more inequities and greater reliance on tax forgiveness." There could be less reliance on some tax forgiveness also, and there could be greater reliance on direct spending programs that are necessary for the people who are suffering because of this present recession.

Do you have any comment?

Mr. DENISON. Yes. We share the same concerns in terms of how this would be applied, and we would see a conflict there. Our experience here over the years has been that generally where a conflict such as this comes about, the people we represent—and this is a large segment of the economy—usually is the loser. If the competition is then within the realm of the number of tax expenditure dollars, whatever they may be and however they may be measured, that then to be the arena where there is to be a maximum on the number of dollars involved. If there is going to be any reduction, we have usually been in support of those programs that get reduced. We would have exposed here, as we see it, another entire area of programs that could suffer because room has to be made for the potential increased cost of, let's say, "all-savers" or the leasing concept or something of that nature that is being sold on the premise that it is going to get the economy started again, that it is going to build jobs and therefore we should suffer in silence in the other part of the tax expenditure group.

Mr. BONIOR. What we are doing now is giving our somewhat political judgment on what is going to happen, and that is something that has obviously got to be considered. But it seems to me that where you have a situation in which you have got \$266 billion, the largest extent of which goes to upper income groups—

Mr. DENISON. But every one of those was enacted by the Congress.

Mr. BONIOR. Yes; and many of them are for good purposes. I guess what I am suggesting is that some of them, when laid right next to some direct spending programs, could not stand the scrutiny.

Mr. CANTOR. But it could work the other way.

Mr. BONIOR. It could work the other way, but I think the odds are much more on my side. And what I hope is your side on this issue, because these things are primarily benefiting those people in a different income category.

Mr. CANTOR. Let me, if I may, Congressman, give an example or two. Mr. Denison and I have worked this beat a long time. When the domestic international sales corporation tax expenditure was offered to Congress, we had a meeting with then President Nixon's Secretary of the Treasury, and it was explained to us, and our support was solicited on the basis that we have an injustice in the code—I don't think the term "loophole" was used, and certainly tax expenditure was not used—but we have a provision in the code called deferral. Deferral allows corporations that operate overseas to defer income taxes on their overseas earnings, so let's have another tax expenditure to preempt this. We will call it the Domestic International Sales Corporation, so that firms get the same kind of benefits for exports and deferral grants for overseas operations.

This is sort of an extreme example of attempts to close off one tax expenditure by adding another, and the variations here are infinite. I guess a good part of what we are saying is I think we are better off, handling tax provisions within a tax bill where the tradeoffs are much clearer.

We can all go down a list, I think, where we are talking about a particular expenditure as opposed to a tax provision that is arbitrarily thrown into a functional category, there can be all kinds of problems.

I am uncomfortable about this, Congressman. We share your concerns about tax expenditures. It is just that we are very uncomfortable with carving it into legislation.

Right now for example, citizens over 55, if they sell their homes, are allowed special capital gains treatment. Now, is this a housing program or should it be lumped under social security? Where would you make these tradeoffs? To ask the question is to answer it. I think there are so many problems with this, and it could go so many ways that we would much rather see, as we said in our statement, a lot more information, particularly as to beneficiaries, before we jump to the assumption that reducing tax expenditures in the aggregate will give us a net good, which is your assumption.

Mr. BONIOR. No; there is no assurance of that.

Mr. CANTOR. I suspect you are correct. Limiting them in the aggregate would, on balance, give us a better tax policy, better gov-



ernment policy, but I think there are a couple of steps beforehand that we would like to see.

Mr. DENISON. Then you have the problem of definition. I think, again, it may be political, but nonetheless it is a very major concern. What is a tax expenditure today that may be decided in Treasury tomorrow is not a tax expenditure. Therefore, if you narrow the range of those tax expenditures, we may end up with only the interest on your home and things of that nature being considered tax expenditures, and if there has to be a cut, then it would be among programs that we would be very concerned about.

We have seen in the last few years in the whole budget process and the budget reconciliation process a use made of the law that I don't think anyone anticipated back in 1974, and in every case it has worked against the average working person in this country. That is our conclusion, and it becomes a very frustrating exercise.

You are unable to deal with this thing because you are dealing with large aggregate numbers, and here again we would be dealing with a large aggregate number under which we have to play the game. And in the years that we spent lobbying the Ways and Means Committee, we found many times by closed rules and other devices that we couldn't get to a tax bill in terms of making an amendment on the floor. It would be even more difficult to get to the same problem if this were in place, I am afraid.

Mr. BONIOR. You can't get to it now because of what you described, the closed rule. There is really no debate on the floor on most tax bills and tax expenditures that are attached thereto in committee. There is not a very good review process in Ways and Means. Out of the 104, last year's activity report, I think, shows they had about 10 tax expenditures they looked at. That is one of the problems that I am trying to address: The fact that once they are ensconced in law, they receive very little review, and we are hopeful that with this legislation they will be brought out in the public light and there will be some changes.

As it is now, you are not getting a shot at them. I suggest that through this legislation that there is another area which we can use in trying to deal with this \$100 billion deficit, instead of just that 30 percent that has been beaten over the head and probably will continue to be beaten over the head in the coming week.

You asked about distribution, who gets the benefits, and I have charts galore here that can answer that. The CRS just put out a report recently that indicated the regressivity of the whole structure, which I suspect is not new to you, but which ought to be, I think, somewhat highlighted before we make a final decision on this.

I thank you for your testimony and understand your problem.

Mr. DENISON. We share with you the frustration and appreciate what you are attempting to do here in terms of raising the consciousness of this. It has been our concern for many years. We saw the tax expenditure area growing in the Ways and Means Committee and the legislation that came from that committee, and almost no attention was paid to it, so this in that respect in this hearing is very helpful.

Mr. PEPPER. Mr. Derrick.

Mr. DERRICK. Thank you, Mr. Chairman.



I don't know that I have a great deal more to add. I thank you very much for coming and appearing before us.

Just to follow up on what Dave has said, this may not be exactly what you want, but I certainly think it is in the right direction. Why shouldn't we review on a regular basis the deduction of interest on home mortgages? The original intent of it was to provide the middle-class American with the opportunity of homeownership, but did that mean that an executive who makes \$250,000 a year should be able to mark off \$50,000 in interest on a home? These are things that we need to look at.

It seems to me that this is the only way we are really going to get to look at them.

Mr. DENISON. We share your concern about that. We feel that the Ways and Means Committee, the Finance Committee, have the same right of oversight to examine that case and all of the other 100 or more tax expenditures, and we share your same concern. Why should a worker who makes \$30,000 and his next-door neighbor who makes \$200,000, living in identical houses, pay more for his house than his neighbor, solely because of the tax structure, because of the interest deduction.

Mr. DERRICK. That is true, but I think the only way you are going to get at these things is to have a public awareness of it.

Mr. DENISON. We appreciate these hearings in that respect. I think our concern goes to our unfortunate experience, as we see it, with the Budget Act and how it has been used over its 6 or 7 years of life. I guess we are just gun shy.

Mr. DERRICK. I can understand that too. I served on the Budget Committee for 4 years, and I will say that things certainly have changed over there since I left in 1978, some for the good, but a lot of it I think has a very detrimental effect on the process.

Thank you very much.

Mr. PEPPER. Mr. Denison, I think we would all agree that it would be helpful if we could keep all these tax expenditures in force, as I said a minute ago, they have grown up like topsy. A few are added on from time to time until you have the accumulation of the present, and very few of us could name more than half a dozen or a dozen at the outside, I would suppose, and yet they tell us over there there are 104 altogether, some of them that we don't even know about or don't realize that they exist, so it would certainly be desirable to take a look at how many have we got, how much are we expending in tax benefits, and then it might be that we would want to reexamine some of them.

Maybe the public policy that led to the adoption of one might not prevail at the present time. For example, with respect to this, I would certainly vigorously oppose any effort to take away the credit for interest paid in the purchase of a home, certainly for the person in the lower- or middle-income group, but I don't know that that necessarily applies to somebody who buys a \$500,000 beach home or a private yacht, unless the public policy would be that it stimulates commerce and employment, and therefore we are buying jobs.

But we are using a fellow that doesn't really need the concession very much in order to do that. It might be better to try to deal more directly with the people that need the job and the like. As it

is now, it makes no difference whether your home costs \$1 million or \$45,000. You get a tax credit for the interest you pay on it, so it would be desirable, it seems to me, every year for the Budget Committee to bring these things into focus, and when we discuss it down there, have a planning board like we have over there detailing what they are.

A lot of Members would say, "I never knew we were giving tax credits on this, that, or the other one." Bring them all into focus and give an opportunity for reexamination to determine whether it is desirable to continue those tax expenditures or not. It seems to me those who have this initiative, Mr. Bonior and whoever else has been working with him, deserves thanks for bringing out the idea of doing this.

Mr. DERRICK. Mr. Chairman, would you yield for just a moment? Let me make one remark. I think we are going to have to get these off-budget items, and I realize this isn't the subject of this hearing this afternoon, but I think before we can really know where we are going financially, and the American people can know where we are going financially, we have to have a budget process that includes direct expenditures, off-budget items, and tax expenditures.

There are probably a couple of other categories that I haven't thought of, but certainly those are the three major ones. If you add tax expenditures together with the off-budget items, two-thirds or substantially over half of the amount of the expenditures is not counted.

That is all.

Mr. PEPPER. If I may divert from the subject of this hearing for a moment, but to take advantage of your being here from the AFL-CIO. As we know, there are about 9 million people in this country that are now out of jobs, and we know there are a lot of bankruptcies, a very high rate of bankruptcies in the country. I haven't seen any figures, but there must be a large number of mortgage foreclosures on homes and farms, because people haven't been able to keep up their payments.

It just occurred to me the other day. Even if only 10 or 100 are going to lose their homes, while we are going through this period of depression, why couldn't we try to save those people's homes by simply going back to procedures that were employed in the Roosevelt days—use the Homeowners Loan Corporation.

I told my staff to get me a copy of the old Home Owners Corporation Act, the old RFC Act, and the act that prevented the foreclosure of farm mortgages, and see about introducing that legislation.

I remember one day after the Homeowners Loan Corporation had been closed out, I was having lunch in the Senate restaurant with a gentleman who was the last man in charge of it. I said, "By the way, how did you come out? How did the HOLC finally come out after all of this experience?"

He said, "We made about \$100 million profit."

Now, it didn't cost the Government a nickel and it made a \$100 million profit saving thousands, if not millions, of homes of people in this country who had gotten, in the days of the Depression, down to the point where they couldn't keep up their payments. There weren't any other loans they could get. Nothing could happen except the loss of a home that maybe they worked and

sweated a lifetime for. It wouldn't cost the Government anything, really, according to that experience.

What would you think about trying to revive some of those things? Aren't there a lot of labor people that are probably going to lose their homes and farms in this country?

Mr. DENISON. Indeed. In February of this year, the AFL-CIO met in Florida at the time the Reagan economic program was first offered. The AFL-CIO at that time offered an alternative program, and that program called for many of the things that you are talking about, reintroduction of the Reconstruction Finance Corporation and the Home Loan Bank Board.

Mr. PEPPER. You say you are in favor of that now?

Mr. DENISON. Indeed, we are. And, as a matter of fact, attached to my testimony is the AFL-CIO's antirecession program adopted at our convention. It says specifically here, "establish a Reconstruction Finance Corporation" and so forth.

Mr. PEPPER. Would you kindly send me a copy of that or give it to me and say that that is the policy of the AFL-CIO?

Mr. DENISON. Yes, sir.

Mr. PEPPER. Let's see if we can't get something going on it. Maybe my colleagues here would join in with others.

Mr. BONIOR. I would be delighted, Mr. Chairman.

Mr. DERRICK. I would like to look it over.

Mr. CANTOR. On that point, Mr. Chairman—

Mr. PEPPER. Are there any other questions? I believe we have no other witnesses scheduled for today. Is there anything else, Mr. Bonior?

Mr. BONIOR. I think this gentleman has a statement.

Mr. CANTOR. Sort of as an aside, much of that program, the Reconstruction Finance Corporation, was targeted tax benefits. In addition, we offered that as an alternative to the tax cut that was enacted last August. In a way we have sort of come full circle because much of the problem that you describe is a result of the excesses in the tax cut which has forced interest rates up, which is forcing these foreclosures.

Mr. PEPPER. I am glad to hear you are concerned. Please let me hear from you on that. Thank you very much.

That completes the hearings for today.

[Whereupon, at 3:15 p.m., the hearing was adjourned.]

## H.R. 4882, TO AMEND THE CONGRESSIONAL BUDGET ACT OF 1974

THURSDAY, DECEMBER 10, 1981

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON RULES,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10 a.m., in room H-313, the Capitol, Hon. John Joseph Moakley presiding.

Present: Representatives Pepper, Long, Moakley, Derrick, Beilenson, Frost, Bonior, and Taylor.

Mr. MOAKLEY. The Committee on Rules will now come to order.

The committee will continue with the hearings of witnesses on H.R. 4882 to amend the Congressional Budget Act of 1974 to require that each congressional budget resolution fix the level of tax expenditures for the fiscal year involved as well as the recommended level of Federal revenues. The committee is privileged to hear from a former Member, a man who distinguished himself as chairman of the Budget Committee, former Representative Bob Giaimo. Bob.

### STATEMENT OF HON. ROBERT GIAIMO, FORMER CHAIRMAN, HOUSE BUDGET COMMITTEE

Mr. GIAIMO. Thank you very much, Mr. Chairman. Members of the committee, it is a pleasure to be here with you today to talk about a subject that is close to my heart, as you know, and that is the Budget Act. In general, I want to say that I applaud what you and the members of the Rules Committee are doing, and that is to look into the Budget Act of 1974 and, I assume, with intentions of making some changes in it.

I think we have now had 7 years since that legislation has been enacted, and I think that it is time for it to be changed.

Certainly Mr. Chairman, it is a pleasure to see you.

Mr. PEPPER. Thank you.

Mr. GIAIMO. I have been seeing a lot of you in the last few days.

Mr. PEPPER. Thank you. It is good to see you here again.

Mr. GIAIMO. Not in person but on television.

Mr. PEPPER. Thank you very much. It is good to see you here again, Bob.

Mr. GIAIMO. Thank you.

I think that there are real reasons and necessities as to why there have to be changes in the act. The hearing this morning, as I understand it, however, confines itself basically to the question of



tax expenditures, and whether or not we should set a limitation in the budget resolution on tax expenditures.

Most likely, yes, in my opinion you should. The reason I am a little hesitant I will explain in a moment. As you know, last year when we had several spending limitation bills, I introduced one which provided for that, in addition to limitations on spending. If you are going to put a limitation on spending—and I was suggesting that you should then and I still do, but that it is not enough to just limit spending.

You really have to look at the question of tax expenditures, because that in effect is another way, as you know, of spending money, and I suspect that today tax expenditures, more than ever, may become the spending legislation of the 1980's. Spending increases, as you know, except for defense, are out of style, and tax cutting is in style, and I fear that we are going to see all kind of new tax proposals by way of the tax expenditure route that will be nothing more than spending programs in the disguise of tax legislation.

Tuition tax credits is one item that comes to mind, the kind of legislation that we are beginning to hear about a great deal, like the Kemp-Garcia type legislation will be one, and there will be many, many others, and because of that I suspect you are really going to get pressure in the early 1980's accomplishing purposes via the tax expenditure route, rather than providing money for a specific program.

Mr. PEPPER. In other words, it is a little easier?

Mr. GIAIMO. It will be a little easier, and it is also attractive and it is also concealed. That is the problem. From that standpoint I say yes, you should provide limitations and try to have some control in your budget resolution for tax expenditures, but the reason I said probably yes, that I would favor your doing this at this time, the only hesitation I have is whether or not you should address changes in the Budget Act in piecemeal fashion.

I would hope that you would make overall changes in the Budget Act, not just taking up tax expenditures on their own, because I don't think you should piecemeal this act. I think it needs changes. I think the inclusion of tax expenditures is one of them that should be included, but I think there are many, many more changes that should be made, and I would like to see a comprehensive-type change by the Rules Committee.

I think it is long overdue and I know this committee has felt that way also. I would hope that in 1982, when you come back here, that you will really look at that Budget Act and make some changes.

Mr. LONG. Would the gentleman yield?

Mr. GIAIMO. Yes.

Mr. LONG. As you know, Bob, I am one who looks at trying to put coalitions together.

Mr. GIAIMO. Right.

Mr. LONG. To make things work. Do you think that we are going to have to put together either a task force or an ad hoc committee consisting of representatives from Ways and Means, the Budget Committee, Rules, and Appropriations, in order to accomplish something? Is this really possible?



Mr. GIAIMO. Is change possible?

Mr. LONG. Is it possible to get that group to agree, from your experience as chairman of the Budget Committee?

Mr. GIAIMO. Yes.

Mr. LONG. There are a lot of natural conflicts that arise. Is it not going to be necessary to get at least all four of those groups represented in any base plan for substantial change in the Budget Act?

Mr. GIAIMO. I would prefer to go the route of consultation with those committees, and I would much prefer to see this Rules Committee—I know you have got problems in that you are a heavily loaded committee, with a great deal of day-to-day legislation which you have to look at, but I would like to see the Rules Committee try to appoint its own task force, a special subcommittee if you will, to do the job, because I am afraid that if you include other committees there will be disagreement and a lesser chance of success. My experience is that there has been a great deal of cooperation between some of the committees that you have mentioned but not with some of the others.

Mr. LONG. Right.

Mr. GIAIMO. I am afraid that rather than trying to make changes that would result in a more effective way of handling the budgetary problems of this Nation there might be efforts to weaken the process. This year that we are just completing points up serious shortcomings in the process—and incidentally, it is the total budget process that has serious shortcomings.

Mr. LONG. That is right.

Mr. GIAIMO. Not just the budget process itself but the appropriations process, which is part of it. Unfortunately, the media these days is confusing many, many things. For example, they are talking about the budget that the Congress is going to take up this week, when in fact it is the continuing resolution that they are taking up, which is an appropriation.

There are all kinds of confusion of this kind in the public, as a result of incorrect reporting, in my opinion, of a very complicated subject, and so there has been a total breakdown this year, not just of the budget process, but of the appropriating process, worse than ever, where we are practically on a continuing resolution for the whole Government, with, I think, the exception of the Interior appropriation, D.C. and legislative.

Mr. LONG. Certainly that is true with respect to the other body.

Mr. GIAIMO. Yes; it is even more so with the other body. So I would prefer to see this committee, the Rules Committee, try to make meaningful changes in the act that I am afraid would not happen if you had a task force or a select committee made up of several other committees. There is one in particular that I would prefer not to name, that I don't think would work too well with the Budget Committee, and vice versa.

Mr. LONG. If you let all the foxes in the henhouse, you are not going to end up with anything. The best thing to do is to keep out the people who don't have a direct jurisdictional interest in it.

Mr. GIAIMO. Yes.

Mr. LONG. And let them work it out in consultation with all those who do have the direct interest; is that correct?

Mr. GIAIMO. I would say so.

Mr. LONG. That is a valid point. I hadn't really thought of it that way but it is a valid point worthy of serious consideration.

Mr. GIAIMO. At that time, then, you would bring in this item.

Mr. LONG. Right.

Mr. GIAIMO. Dealing with tax expenditures. It is going to be very difficult, incidentally, to select a number on tax expenditures, as you know. You are going to have real problems of estimating; real problems of scorekeeping; what is a tax expenditure; what would the limitation be, say, on day-care money, and expenditures of that type, but it could be done, and it would be a start.

Certainly if you don't include it, I am afraid that there will be a great big back door opened.

Mr. PEPPER. Bob, what concerns me, and I think many Members—and we had a good example of it last year when the budget resolutions were passed—you give one committee enormous power, and the way it was exercised in the reconciliation resolution, it gave that committee the authority to recommend the elimination of legislation, the repeal of legislation, so you had practically the Legislative and Appropriations Committee, and the Appropriations Committee was left only to determine within the ceiling how the money would be allocated among the subjects of the appropriation.

Now, we saw an example of how it is possible to put an awful lot of pressure on that one committee, that Budget Committee, which enables them to exercise an enormous amount of power. On the other hand, I don't know how you get around it. I don't know how you can avoid, if you are going to establish an overall ceiling—somebody has to do it, and I don't know of any alternative or any option that apparently would be better, but I am sure you are very much aware of that fact.

Mr. GIAIMO. It is, in fact, however, a committee with very little power, even though it deals with a subject matter which has great power, but the committee, perhaps by virtue of the fact that it is a revolving committee, has nothing near the kind of inherent power that I have observed in this place in 22 years as a Member that other committees have. However, in an emergency situation, which we were in this year, and which you are going to be in, Lord knows, probably even more when the President sends up his budget in January, certain drastic steps had to be taken by the full House and Senate, and that was the reconciliation process.

Now, I was part of the first reconciliation bill of last year, and I was part of the meetings, as was Chairman Bolling. The meetings that we had, House and Senate, were, I think, 8 days straight in the majority leader of the Senate's office at that time, Senator Byrd, when we in fact agreed upon the necessity for reducing spending by, I think it was about \$11 billion, and the only way we could get this through would be to package it, because it did affect legislative changes.

This was a year ago March, when President Carter revised his budget, because of the collapse of the bond markets, and it was an emergency situation. It was even more so this year, when President Reagan came up with his proposal, and the Congress did with the massive reconciliation package of about \$35 billion.

Now, when you are dealing with those kinds of massive cuts, the only way the House and Senate can act in that capacity, in my

opinion, when they have to act in a hurry, is for the House and Senate almost to act as a Committee of the Whole, and the Budget Committee by definition becomes the vehicle for the leadership to implement this massive package which has to be done, the leadership or the majority as it turned out to be, in the case of the House with the substitution, the Gramm-Latta bill, it was the majority that mandated, and the Budget Committee acted expeditiously, quickly, and properly, as their functioning committee to accomplish this.

The Budget Committee can do nothing in my opinion without the assistance of the leadership in the House and Senate, so it is controlled in that sense, and it isn't going to become a supercommittee, as other committees have become in the past. But you see when you are dealing with what you have had now in the 1982 budget, and which we had in the 1981 budget, with large reductions, there is a natural reluctance in Congress to accept them—witness what has happened on your appropriation bills this year—a reluctance to implement and approve the appropriations and therefore resultant inaction by the Congress on the specific spending bills.

Why? Because it means drastic reductions, particularly in the other body, where it is the President's party that would have to make these reductions, and the resistance is coming from them also. In that instance you are going to need some form of extraordinary type legislation, whether it is reconciliation or something else to do it, or you are not going to get the job done.

Mr. PEPPER. Thank you. Anything else, Mr. Giaimo?

Mr. Bonior?

Mr. BONIOR. Thank you, Mr. Chairman.

Thank you, Bob, for coming and giving us your feelings on this issue and the budget process in general. Before I ask you a couple of questions about H.R. 4882, the bill under consideration this morning, what are your feelings about the budget process with respect to a second budget resolution? Yesterday we had the Budget Committee come in here and ask for a second budget resolution, which basically is a facade for getting, for fulfilling the obligations of the act. The resolution that we will have before us in the full House has the old figures with a \$42 billion deficit.

Mr. GIAIMO. Right.

Mr. BONIOR. Do we really need a second budget resolution?

Mr. GIAIMO. Let me say for the record that you and I have not spoken before this meeting and planned this question, but thank goodness you asked me that question, because I think it is a great question, and it is something that I have been thinking about probably more than anything else for the last 6 months.

You know that in addition to now being a practicing attorney here in town, I am also involved with the Committee for a Responsible Federal Budget, which is a pro bono publico group that I and Senator Bellmon head up, and we have our former colleagues, Brock Adams and Ed Muskie on it; also Jim McIntyre, Alan Greenspan, Jim Lynn, and many people who are involved with budgeting. It is bipartisan. We are concerned because we want to see this process succeed. We think it is essential, but I think you have asked the \$64 question.



In my opinion and I am not speaking for the Committee for a Responsible Budget now at all because we haven't taken a position on this, but in my own personal opinion I think that is one of the major changes that has to be made. I think it is insane now that we are asking Congress to go through this agony twice, and within such a short period of time, in May and then again in September. You know very well that with the volatility in our economy, we have to go through it again with the third resolution, in the springtime when we are halfway into the fiscal year, and when we have a much better estimate of what that fiscal year is going to look like.

Yes; I would like to see some change so you could eliminate that September resolution. Now, people are criticizing the September resolution which came before you yesterday, and which is coming upon the floor. It is presently on the floor of the Senate and I suspect you are bringing it up here in the next day or two. People are criticizing it and saying its numbers are wrong.

Well, of course they are, but the fact is that in effect what you are really doing now is you are saying: Look, we are taking the first resolution, and we are making that one the binding resolution.

It is almost as if you are saying, as we had suggested both last year and I think the Budget Committee suggested this year, but it was then taken out of the bill, that if you don't adopt the second resolution by September 15, the first one becomes binding.

That is not a bad idea. In fact it is the route to take. The trouble with that is it gets you into tremendous conflicts along the lines that Congressman Long and I were just discussing about the competition between committees, because you are in effect saying then back in May, you are going to be saying this is what we think the problems are going to look like for the coming fiscal year; this is what we think the economic estimates are, and this is the amount of money which we think Congress can spend and should tax or raise in revenues, and therefore this is it. And it is binding, and you give that constraint to the Congress and to the committees, and in effect you tell them to work with that total pot of money and no more.

Well, I happen to think that that is the way you are going to have to get to budgeting, and then if there have to be increases in it, you are not going to know those truly in October and November, but you will have a pretty realistic view in the springtime, when your supplementals and all come up, and at that time you readjust for the fiscal year, so I would like to see, if it is possible to work it out without bad feelings with other committees, an elimination of that second resolution, and making that first one binding to that degree as stated.

I think that would save an awful lot of confusion and necessary controversy that Congress is constantly engaged in at this time.

Mr. PEPPER. Will the gentleman yield?

Mr. BONIOR. I yield.

Mr. PEPPER. I was informed that the resolution we voted out here just yesterday has exactly the same figures in it that the May one does. I was told by Mr. Jones on the floor, the way I understood him, that this resolution is the same as the May one.

Mr. GIAIMO. That is what I understand myself, but I haven't seen the one out of committee, but I believe it is. Isn't that right?

Mr. BEILENSEN. Absolutely.

Mr. GIAIMO. Just one sentence. In effect what you are doing now, you are saying we are making the first one binding, and this provision actually was entertained in an early draft of the first budget resolution, and then there was objection, as I recall, within the committee from some of the members and it was dropped. I think that is the area, Mr. Bonior, I think that is the real area that you have got to concentrate on in this committee in any basic change of the act, that second budget resolution.

Mr. BONIOR. Getting back to H.R. 4882, Jim Jones, your successor, appeared yesterday and gave a measured endorsement of the bill, and in your description of the problem of proliferation of tax expenditures this morning I think you used the adjectives "attractive, easier and concealable." The question I have is this: Would H.R. 4882 have been a valuable tool to you when you were chairman of the committee in the last Congress?

Mr. GIAIMO. I can't really answer that. I would have to really go back and study it. I don't think it was that much of an issue during my years as chairman, but I think it is going to be now.

Mr. BONIOR. Yes; I think you are correct in assessing the growth.

Mr. GIAIMO. Right.

Mr. BONIOR. It is growing at about 14 percent and direct spending at 11 percent.

Mr. GIAIMO. It was an issue with us last year when we got into the discussion of limitation bills. You will recall that there were many proposals to have spending limitations imposed. In fact, Chairman Jones had the key bill, and I believe what he wanted was a limitation of total spending at 23 percent or somewhere in that area, with a graduated reduction down. My suggestion was to have a limitation which would encompass both spending and tax expenditures, and say at a figure I believe perhaps somewhere in the neighborhood of 28 percent total for both of them.

Mr. BONIOR. Thank you.

Mr. PEPPER. Thank you. Mr. Derrick.

Mr. DERRICK. Thank you, Mr. Chairman.

Bob, I thank you for coming up this morning.

Mr. GIAIMO. Thank you for inviting me.

Mr. DERRICK. It is good to see you.

Under H.R. 4882—let me ask you this—Congress would be accepting more responsibilities, and generally what we do to take care of them is to hire more staff. Do you think that if H.R. 4882 is passed and tax expenditures are included that this would bring about regular reviews on tax expenditures? Do you really think the House is capable of such review in an efficient way?

Mr. GIAIMO. Is it capable of tracking tax expenditures, you mean?

Mr. DERRICK. Right, and making substantive judgments.

Mr. GIAIMO. I have to tell you, I think one of the best things that we have ever done in this Congress—and I wouldn't have said this 5 years ago, I wouldn't have said it 2 years ago—one of the best things I think that we have done in this Congress was to set up the CBO operation which we have, and they have been more on track in my opinion than OMB. Witness the fact that they were telling the administration about the high deficits for 1982, 1983, and 1984,



way before they realized it downtown. I think they have the capability of doing it.

Now having said that, in the area of tax expenditures it is not going to be easy to set up that kind of a scorekeeping operation. How much are your tax expenditures going to be, say, in the area of day care, for example? You don't know. It is hard to tell.

It depends upon how many people take advantage of the tax expenditure legislation you might pass. But we do the same thing in many other areas. Certainly agriculture is a very volatile area that we have to deal with, so I think it is possible to do, and I think that we have developed the staff expertise here in the Congress that, as you know, we didn't have before the passage of the 1974 act. We were pretty much in ignorance of what was happening in the economy. Today at least we know, or at least we know equally with the people downtown, and many times even better.

Mr. DERRICK. I am interested in your change on the CBO.

Mr. GIAIMO. That is right.

Mr. DERRICK. Because I can very well remember when your position was the opposite of what you have just said.

Mr. GIAIMO. In my opinion they are serving the Congress well.

Mr. DERRICK. I think so. I agree with you.

Let me ask you this. As a member of the business community, do you think businesses which engage in long-term planning will face increased uncertainty if H.R. 4882 is passed? This is a question I asked several times yesterday, but it is something that the business community always raises about tax expenditures. To begin with, they don't want tax expenditures.

Mr. GIAIMO. They don't want it in many instances.

Mr. DERRICK. They take a different approach, but they say that it would be very difficult to enter into any long-term planning if tax expenditures are to be reviewed on a regular basis, and, in addition, subject to aggregate figure limitations on a regular basis. Would you comment on that.

Mr. GIAIMO. I do know that business in general does not favor the Congress getting into the area of tax expenditures, and I suspect it is because of the last thing you just said, that as you look at them and study them and watch their growth, you are apt to make changes and reduce them.

In general let me say this, that the business community is vitally interested, however, and very much supportive of the budget process, extremely supportive, because they recognize the need to make greater efforts in budgetary controls of all types, so that we in the Government, you in the Government know where you are going and what the effects of your actions will be in the coming fiscal year, and in fact in the projected fiscal years thereafter. Their opposition would be muted by that consideration, I suspect.

Mr. DERRICK. Thank you.

Mr. PEPPER. Are there other questions? Mr. Taylor.

Mr. TAYLOR. Bob, I would like to express my appreciation for your being here today, and I think certainly everyone has a great deal of respect for your expertise in this field, the fine job you did when you headed that committee.

Bob, I would like to ask, how can practically the CBO, or anyone else for that matter, keep score on revenues lost due to tax deduc-

tions, credits, exemptions and so forth? Isn't that going to be a mammoth challenge?

Mr. GIAIMO. Yes. I hope I indicated just a few moments ago that it wasn't going to be easy to do, but that I am confident that you can get some form of reasonable estimates that will serve you well, as in fact you know we have that in our outlay programs now, separate and apart from tax expenditures.

How do we estimate what our disaster programs are for the year—and yet we do. We have to put in numbers, actual numbers on what we expect disasters will be. How do we know what the weather will be in agriculture, for example? How do we know what the economy will be, and therefore its effect on unemployment compensation? It can be done within reasonable estimates.

Perhaps another thing we ought to look at in this Budget Act, as we change it, part of the problem in my view is that we have to decide back in the springtime, and then in the fall what is going to happen next year. We don't have the benefit of a contingency account. Some people have argued that perhaps we ought to have a contingency account in the budget, a cushion, if you will, both on spending and perhaps in the area of the revenues to accommodate the uncertainties that you raise.

I recall once quite a few years ago—and you might want to look back into it—when Chairman Bolling testified before the Budget Committee—I don't want to misquote him—I think at one time he was commenting on the possibility of a contingency item of about \$10 billion at that time. Do you remember that? You might want to check that and see what he had to say on the subject at that time. It was about 5 years ago.

Mr. TAYLOR. Thank you, Bob.

Mr. PEPPER. Mr. Giaimo, you have rendered great service to your country as well as to your district and State in the many years you were here, and we have profited greatly by having you come back and advise us.

Mr. GIAIMO. Thank you, Mr. Chairman, and I am really happy that this committee is looking at the act, because I really think that there is a great job for you to do here in the not far distant future. Thank you.

Mr. PEPPER. Thank you very much.

Our next witness is the Honorable Stuart Eizenstat, former Assistant to the President for Domestic Affairs.

Mr. Eizenstat, we all know that you rendered outstanding service to your country in the years that you were Assistant to the President for Domestic Affairs during the last administration, and we are delighted to have you here today.

#### STATEMENT OF STUART E. EIZENSTAT, FORMER ASSISTANT TO THE PRESIDENT FOR DOMESTIC AFFAIRS

Mr. EIZENSTAT. Thank you, Mr. Chairman. I appreciate the invitation. I ask that my complete statement be incorporated into the record and I will give excerpts of it this morning.

Mr. PEPPER. Without objection.

Mr. EIZENSTAT. I support the attempt of H.R. 4882 to bring tax expenditures under greater budgetary control, for they involve

spending in much the same way as direct expenditures, have the same impact on the Federal deficit, involve the same congressional intention to directly affect behavior to achieve a socially beneficial purpose as direct spending programs, and, therefore, should be subject to the same budget discipline as such spending programs are under the Budget Act of 1974.

Tax expenditures are recognized as expenditures in which the budget process should have an interest, and are defined within the 1974 act as:

Those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.

In order for bills such as H.R. 4882 to have any chance of success it is critical to appreciate that tax expenditures are not simply private spending. Rather they represent decisions initially made by the House Ways and Means Committee and the Senate Finance Committee and endorsed by the Congress and President, to use public funds, which could otherwise have been used for general tax reductions, reductions in the deficit, or direct spending programs, to achieve certain public goals, funds which otherwise could be used for general tax reductions, reductions in the deficit or direct spending programs.

There is nothing in any way illegitimate or improper about tax expenditures. Many are among the most popular Government programs—such as energy tax credits to encourage conservation or the mortgage interest deductions to encourage homeownership. Their inclusion does not suggest the need for their elimination—only for their continued scrutiny and review. But they are too important to escape meaningful budget review, for a variety of reasons.

First, their cost is enormous and the growth explosive. For fiscal year 1981, the Congressional Budget Office identified 92 tax expenditures, which the Joint Committee on Taxation has estimated, cost the Federal Treasury more than \$228 billion—about 25 percent of total direct expenditures. Congress simply cannot permit this level of expenditure—albeit through tax reductions—to remain outside the budget process it has created, the purpose of which was to discipline the Government to live within revenue and expenditure limits. This is even more clearly the case when it is recognized that in 5 years the cost of these tax expenditures is anticipated to reach between \$465 billion and \$553 billion.

Tax expenditures have been the most rapidly growing area in the Federal budget—having increased since 1975 at an annual rate of 14 percent compared to a growth rate of 11 percent for direct spending. This explosive growth can be expected to continue given the pressures to reduce the growth of direct spending programs. Tax expenditures are hidden Federal spending, defended as simply reductions in private tax burdens, and do not count in the calculation used to measure Government spending as a percent of the gross national product.

It is this percentage, which does not include tax expenditures, which President Reagan wishes to reduce from its current level of about 23 percent to 18 percent over the next several years, and it is this percentage which many Members of Congress wish to arbitrar-



ily cap by statute or constitutional amendment. How ironic to exclude in these efforts an increase in spending through special tax preferences.

Tax expenditures receive no regular review since they are outside the authorization and appropriation process and thereby become more attractive vehicles with the pressures on direct spending. One hardly accomplishes anything lasting to squeeze direct spending only to have it pop up as a tax expenditure. Thus, despite the massive budget cuts for fiscal year 1982, no money was cut from the \$266 billion tax expenditure budget for 1982 and, indeed, the Economic Recovery Tax Act of 1981 authorized \$13 billion in additional, new tax expenditures for 1982.

Mr. PEPPER. What was that figure?

Mr. EIZENSTAT. \$13 billion in the new tax act that was passed this year, Mr. Chairman.

Nearly 90 percent of the tax expenditures do not require periodic reauthorization and most get no official review.

A second reason for including tax expenditures within the parameters of the Budget Act, as H.R. 4882 seeks to accomplish, is to subject this area to the same regular review as the authorization and appropriation process is intended to provide, albeit imperfectly, for direct spending programs—even if it does fully accomplish this goal—and to require Congress to evaluate their priorities in the competition for scarce budget resources.

Alice Rivlin, the Congressional Budget Director, has noted, as have others, that some 70 percent of the spending side of the budget is not easily subject to budgetary control because of entitlements, fulfillment of prior years' defense obligations, or interest on the national debt. When the huge amount of tax expenditures are put into this context, also not well controlled by the budget process, it becomes more evidence the congressional goal that the Budget Act of 1974 would help Congress set clearer national priorities has only partially been achieved. "Control" and "accountability" are the keys to effective budgeting and priority setting. Tax expenditures currently undermine that necessary control when they are outside the budget process.

Third, unless tax expenditures are brought within the budget process it will be impossible for Congress and the President to focus on and synthesize the close relationship between tax expenditures and direct spending programs which attempt to accomplish similar results. Tax expenditures are alternative ways of achieving public policy goals.

I can state that from a Presidential and executive branch perspective there is no effective executive branch means to compare tax expenditures and direct expenditures in the same area or to seriously determine if they could be better coordinated to achieve a common result. That is to say, when we put our budgets together we always concentrated on the spending side rather than looking at the tax expenditures in the same area. The same is undoubtedly the case with the Congress.

The budget encourages housing both through direct means—section 8 rent subsidies and other subsidized construction and renovation programs—and through tax expenditures—deductibility of mortgage interest and property taxes on owner-occupied homes, de-

ferral of capital gains on the sale of homes. It seeks to boost economic development by direct grant programs—UDAG, CDBG, SBA, EDA, FMHA, EPA—but also through the tax system—tax-exempt industrial development bonds.

It spends money directly on a variety of social services—Legal Services Corp., title XX, AFDC—while it is accomplishing similar goals through tax expenditures—exclusion of contributions to pre-paid legal services plans, credit for child and dependent care expenses. It provides for better health care directly—medicaid—and indirectly—deductibility of certain medical expenses, exclusion of employer contributions for medical insurance premiums and medical care. It seeks to achieve energy goals by direct spending—solar bank, low income weatherization, community conservation program—and by “tax spending”—various energy tax credits.

At times these activities are clearly contradictory but the budget process does not permit such an analysis. As one study noted, “At the same time that the Federal Government is subsidizing new hospitals financed with tax-exempt bonds, it is closing down all eight public health service—PHS—hospitals.”

In the future in an area of your great concern, Mr. Chairman, national health insurance, certainly it would be inappropriate to go forward with national health insurance without at the same time looking at the tax expenditures in the medical area and coordinating those with any program of direct spending, so that they are both going in the same direction and they both achieve common means. Certainly one would want to carefully review all tax provisions affecting health care before deciding on the appropriate course for national health insurance.

A tax credit included in taxable income is equivalent in value to an equivalent direct grant; a deferred tax liability can be the equivalent of a loan program.

Fourth, while this in no way disqualifies them or denegrates their importance, tax expenditures, relative to direct spending programs, tend to upwardly redistribute income, since only taxpayers that itemize their deductions can file for a tax expenditure. Now less than one-third, essentially the more affluent, of the taxpayers file itemized deductions. Moreover, the wealthier the taxpayer, the greater the benefit. A \$100 tax deduction saves a taxpayer in the 50-percent tax bracket \$50 but only \$14 for a 14-percent taxpayer. An overwhelming percentage of tax expenditures go to upper-income groups.

Non taxpayers are generally completely excluded from the benefit of tax expenditures—absent a refundability provision, which the Congress has been loath to adopt.

If direct grant programs are the subsidies for the low incomes, tax expenditures tend to be for the higher incomes. The latter are equally deserving of budget accountability as the former.

Fifth, the fact that direct spending is covered by the Budget Act and tax expenditures are not can lead to the artificial structuring of new programs as tax expenditures which would then go directly to the tax-writing committees in the House and Senate. These committees are gradually controlling more and more areas of the Government. I have enormous respect for the expertise of members of the Finance and House Ways and Means Committees and for their



staffs. They are among the most able in the Congress. But their expertise is tax, Mr. Chairman, rather than energy, education, housing, or the like.

Proliferating tax expenditures not only strain the expertise of the tax-writing committees, but they test the capacity of the Internal Revenue Service itself, which lacks the expertise in nontax issues, and I can testify with some authority, with little enthusiasm for administering such tax expenditures.

Equally important, at a time when American taxpayers rightly insist on careful evaluation of programs, and the elimination of fraud and abuse in entitlement programs for the disadvantaged, it is important to remember that only audits by the Internal Revenue Service can exert any control over tax expenditures which are entitlements for the more advantaged in society. Yet the IRS is already so strapped that it can perform audits only in very few instances.

CBO recently noted in a recent study on tax expenditures that only about 2 percent of the returns are audited and many subsidy programs in the tax system have eligibility rules that rely on information which tax auditors rarely check.

In addition, while it is easily apparent on a relative basis when spending for entitlements is increasing, since checks are being sent out and there is, therefore, some control, unexpected increases can occur in tax expenditures without it being possible to easily determine, absent some budget discipline.

A former Assistant Secretary of the Treasury, Stanley Surrey, noted that the tax committees have the jurisdictional ability to take over much of the legislative field by providing a tax answer to the issue. I must say, Mr. Chairman, they have not been bashful in recent years in exercising that ability. This trend can be at least slowed if tax expenditures and direct spending receive comparable budget treatment.

H.R. 4882 is not asking Congress to take a giant, risky step into the great unknown. Rather, it is a rather natural progression of a series of steps taken over the last decade and a half to develop better oversight in the tax expenditures area.

This concept began to receive serious attention in the late 1960's. In 1968, for example, the Treasury Department published the first tax expenditure budget, listing tax expenditures in accordance with direct budget categories, and making comparison with direct spending programs.

Pursuant to an 1971 congressional directive, similar lists were published in later years by the Congressional Tax Staff.

Then in 1974, through the Budget Act, Congress took a further step in controlling tax expenditures by specifically recognizing and defining tax expenditures and establishing requirements which they must meet. Thus, for example, once an overall revenue floor is established by the second resolution, any legislation to reduce total revenues below that floor would be subject to a point of order. Hence, any increase in tax expenditures would have to compete with all other revenue-losing provisions, including general tax cuts, for the amount of tax reduction permitted by that resolution.

This is somewhat similar to the control over direct spending programs provided by the overall spending ceilings.

The act also requires 5-year projections of the estimated levels of tax expenditures by budget to be included in Budget Committee reports accompanying the first concurrent resolution. Committee reports on all bills with new or increased tax expenditures must include 5-year estimates of revenue loss.

The tax expenditure budget is also published by the executive branch each year with the President's budget, followed several months later by Joint Taxation Committee 5-year projections of estimated tax expenditure revenue losses, and these are then included in the Budget Committee reports in the first resolution.

However, despite all of this, the need for action is seen by the fact that the budget resolutions do not set targets for tax expenditures by functional categories as they do for direct spending programs, and the tax committees are not allocated target ceilings for tax expenditures, as legislative committees receive for their direct spending programs, and it is this that is required.

My point in bringing the history up, Mr. Chairman, is to show that enough material is available to make this additional step a feasible one. Indeed, Congress made other efforts to control tax expenditures directly, as in 1976 when the House and Senate Budget Committees attempted to exert some control over the level of tax expenditures by providing for a \$1 billion increase in revenues through tax reform legislation. This effort did exert a significant influence on the tax-writing committees.

In conclusion, Mr. Chairman, in addition to my general support for the bill, I would like to make the following observations:

Tax expenditures should be classified according to the same functional categories used by the Budget Committees for direct expenditures, to aid in synthesis and comparison between the two types of expenditure programs.

No bill increasing tax expenditures should be considered prior to the first budget resolution.

Tax committees should be required, as all other committees, to report to the Budget Committees by March 15 on proposals regarding tax expenditures by functional category, so that the Budget Committees could state their assumptions regarding direct and tax expenditures in each category that underlies their overall revenue and outlay recommendations.

The Budget Committees should be able to set a level of tax expenditures for the tax committees just as they do for the legislative committees.

Congress should, however, avoid arbitrary limits on tax expenditures by percentage, which would bind future Congresses. H.R. 4882 wisely avoids this straitjacket.

Serious consideration should be given to incorporating into H.R. 4882 some of the ideas in Senator Kassebaum's bill, S. 193. That bill in part provides for a joint referral of new or expanded tax expenditure measures both to the tax-writing committees and to the legislative committees with jurisdictions over the subject matter covered by that tax expenditure. It also requires actual authorization by those legislative committees of any new tax expenditure.

I do think this in part is necessary. However, it should be accompanied with strict timetables in the legislative committees to insure they act properly. It is not clear to me that actual passage

should be required by the second legislative time, but certainly the opportunity for consideration is crucial.

This joint referral procedure would be a major step forward in achieving some coordinated consideration of direct and indirect spending provisions, of securing the expertise of the legislative committees in any new tax expenditure, and of requiring a decision as to whether the public policy goal can best be achieved by a direct spending program or by a tax expenditure program, which is a critical decision now not institutionally possible.

Again, there is precedent for such a step of joint referral, as legislative committees have held hearings and issued reports on tax expenditures covering subject matters within their jurisdiction, but it is simply not done on any uniform and regular basis.

One must be realistic about the ability to easily control any particular tax expenditure on a year-to-year basis. While at least theoretically a limit can be placed on a direct entitlement program, and can be enforced by simply sending out no more money when a ceiling is reached, or a reduced prorata amount to enforce the ceiling, this cannot be effectively done with tax expenditures, because the amount of any one expenditure in terms of its cost is not directly in the Government's control. It depends both on economic factors and on the number of eligible taxpayers who choose to use the tax expenditure. This information may not be known until after the fiscal year is over, and a thorough analysis has been performed.

There are other difficult issues which must be tackled, such as the method of dealing with refundable tax credits, which have elements of both direct and indirect spending.

Whenever possible, the budget process should be used to encourage the tax-writing committees to exercise greater oversight in the tax expenditure area, and to write new tax expenditures with scheduled expiration dates to permit Congress to evaluate the programs after a few years of experience.

It is true, going to Congressman Derrick's point, that this may create some uncertainty with respect to taxpayers who use the tax benefit. However, the same problem also arises for recipients including State and local governments of direct programs that must undergo regular oversight hearings and scrutiny. This is, therefore, not a problem that is known only to tax expenditures. I believe, however, that this problem is far outweighed by the benefits of such regular review, in assuring greater accountability in the use of taxpayers' money. Formal "sunset reviews" may be another effective mechanism to achieve periodic review and reconsideration of tax expenditures.

Inclusion of tax expenditures in the budget process does, however, add another level of complexity to a budget process already taxing the capacity of Congress to act within the fiscal year. A serious review of the whole budget process is in order, as Congress continues to find it difficult to finish its budget and appropriations process in time for the fiscal years being worked on.

I do not think this in any way negates the need to include tax expenditures in the budget process. No one should underestimate the difficult legislation like H.R. 4882 will have in securing passage, because of some of the jurisdictional problems involved with

the tax-writing committees, but nonetheless it is worth the effort to achieve the necessary accountability.

[Mr. Eizenstat's prepared statement follows:]



## TESTIMONY

OF

STUART E. EIZENSTAT\*

BEFORE THE  
HOUSE COMMITTEE ON RULES  
ON H.R. 4882

December 10, 1981

In general, I support the attempt of H.R. 4882 to bring tax expenditures under greater budgetary control, for they involve spending in much the same way as direct expenditures, have the same impact on the Federal deficit, involve the same Congressional intention to directly affect behavior to achieve a socially beneficial purpose as direct spending programs, and, therefore, should be subject to the same budget discipline as such spending programs are under the Budget Act of 1974.

Tax expenditures are recognized as expenditures in which the budget process should have an interest, and are defined within the 1974 Act as:

"Those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." 1/

In order for bills such as H.R. 4882 to have any chance of success it is critical to appreciate that tax expenditures

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\*Mr. Eizenstat served as Assistant to President Carter for Domestic Affairs and Policy from 1977-1981. He now practices law as a partner in the Washington office of Powell, Goldstein, Frazer & Murphy.

1/ Budget Act of July 12, 1974, Pub. L. No. 93-344, 88 Stat. 297, §3(a)(3).



are not simply private spending. Rather they represent decisions initially made by the House Ways and Means Committee and the Senate Finance Committee and endorsed by the Congress and President, to use public funds, which could otherwise have been used for general tax reductions, reductions in the deficit, or direct spending programs, to achieve certain public goals.

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There is nothing in any way illegitimate or improper about tax expenditures. Many are among the most popular government programs--such as energy tax credits to encourage conservation or the mortgage interest deductions to encourage homeownership. Their inclusion does not suggest the need for their elimination--only for their continued scrutiny and review. But they are too important to escape meaningful budget review, for a variety of reasons.

First, their cost is enormous and the growth explosive. For FY 1981, the Congressional Budget Office identified 92 tax expenditures, which the Joint Committee on Taxation has estimated cost the Federal Treasury more than \$228 billion--about 25 percent of total direct expenditures. Congress simply cannot permit this level of expenditure--albeit through tax reductions--to remain outside the budget process it has created, the purpose of which was to discipline the government to live within revenue and expenditure limits. This is even more clearly the case when it is recognized that in five years the cost of these tax expenditures is anticipated to reach between \$465 and \$553 billion.

Tax expenditures have been the most rapidly growing area in the Federal budget--having increased since 1975 at an annual rate of 14 percent compared to a growth rate of 11 percent for direct spending. This explosive growth can be expected to continue given the pressures to reduce the growth of direct spending programs. Tax expenditures are hidden Federal spending, defended as simply reductions in private tax burdens, and do not count in the calculation used to measure government spending as a percent of the gross national product. It is this percentage, which does not include tax expenditures, which President Reagan wishes to reduce from its current level of about 23 percent to 18 percent over the next several years, and it is this percentage which many Members of Congress wish to arbitrarily cap by statute or constitutional amendment. How ironic to exclude in these efforts an increase in spending through special tax preferences.

Tax expenditures receive no regular review since they are outside the authorization and appropriation process and thereby become more attractive vehicles with the pressures on direct spending. One hardly accomplishes anything lasting to squeeze direct spending only to have it pop up as a tax expenditure. Thus, despite the massive budget cuts for FY 1982, no money was cut from the \$266 billion tax expenditure budget for 1982 and, indeed, the Economic Recovery Tax Act of 1981 authorized \$13 billion in additional, new tax expenditures for 1982. Nearly 90 percent of the tax expenditures do not require periodic reauthorization and most get no official review. 2/

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2/ Common Cause, The Untouchables, September 1981, pp. ii, 6.

A second reason for including tax expenditures within the parameters of the Budget Act, as H.R. 4882 seeks to accomplish, is to subject this area to the same regular review as the authorization and appropriation process is intended to provide for direct spending programs (even if it does fully accomplish this goal) and to require Congress to evaluate their priorities in the competition for scarce budget resources.

Alice Rivlin, the Congressional Budget Director, has noted, as have others, that some 70 percent of the spending side of the budget is not easily subject to budgetary control because of entitlements, fulfillment of prior years' defense obligations, or interest on the national debt. When the huge amount of tax expenditures are put into this context, also not well controlled by the budget process, it becomes more evident the Congressional goal that the Budget Act of 1974 would help Congress set clearer national priorities has only partially been achieved. "Control" and "accountability" are the keys to effective budgeting and priority setting. Tax expenditures currently undermine that necessary control when they are outside the budget process.

Third, unless tax expenditures are brought within the budget process it will be impossible for Congress and the President to focus on and synthesize the close relationship between tax expenditures and direct spending programs which attempt to accomplish similar results. Tax expenditures are alternative ways of achieving public policy goals.

I can state that from a Presidential and Executive Branch perspective there is no effective effort to compare tax expenditures and direct expenditures in the same area or to seriously determine if they could be better coordinated to achieve a common result. The same is undoubtedly the case with the Congress.

The budget encourages housing both through direct means (Section 8 rent subsidies and other subsidized construction and renovation programs) and through tax expenditures (deductibility of mortgage interest and property taxes on owner-occupied homes, deferral of capital gains on the sale of homes). It seeks to boost economic development by direct grant programs (UDAG, CDBG, SBA, EDA, FMHA, EPA), but also through the tax system (tax exempt industrial development bonds).

It spends money directly on a variety of social services (Legal Services Corporation, Title XX, AFDC) while it is accomplishing similar goals through tax expenditures (exclusion of contributions to prepaid legal services plans, credit for child and dependent care expenses). It provides for better health care directly (Medicaid) and indirectly (deductibility of certain medical expenses, exclusion of employer contributions for medical insurance premiums and medical care). It seeks to achieve energy goals by direct spending (Solar Bank, low income weatherization, community conservation program) and by "tax spending" (various energy tax credits). 3/

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3/ The Untouchables, supra. pp. 8-17.

At times these activities are clearly contradictory but the budget process does not permit such an analysis. As one study noted, "At the same time that the Federal government is subsidizing new hospitals financed with tax-exempt bonds, it is closing down all eight public health service (PHS) hospitals." <sup>4/</sup>

Certainly one would want to carefully review all tax provisions affecting health care before deciding on the appropriate course for national health insurance.

A tax credit included in taxable income is equivalent in value to an equivalent direct grant; a deferred tax liability can be the equivalent of a loan program.

Fourth, while this in no way disqualifies them or denegrates their importance, tax expenditures, relative to direct spending programs, tend to upwardly redistribute income, since only taxpayers that itemize their deductions can file for a tax expenditure. Now less than one-third, essentially the more affluent, of the taxpayers file itemized deductions. Moreover, the wealthier the taxpayer, the greater the benefit. A \$100 tax deduction saves a taxpayer in the 50 percent tax bracket \$50 but only \$14 for a 14 percent taxpayer. An overwhelming percentage of tax expenditures go to upper-income groups.

Non-taxpayers are generally completely excluded from the benefit of tax expenditures--absent a refundability provision rarely adopted.

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<sup>4/</sup> Ibid., p. 15.



If direct grant programs are the subsidies for the low incomes, tax expenditures tend to be for the higher incomes. The latter are equally deserving of budget accountability as the former.

Fifth, the fact that direct spending is covered by the Budget Act and tax expenditures are not directly controlled and do not go through the authorization and appropriation process, can lead to the artificial structuring of new programs as tax expenditures, which must go only to the tax-writing Committees of the House and Senate. These Committees gradually control more and more areas of the government. I have great respect for the expertise of the Members of the Senate Finance and House Ways and Means Committees and for their staffs; they are among the ablest in the Congress. But their expertise is tax--rather than energy, education, or housing.

Proliferating tax expenditures not only strain the expertise of the tax-writing Committees but likewise test the capacity of the Treasury and the Internal Revenue Service, which lacks expertise in non-tax issues and has little enthusiasm for administering tax expenditures.

Equally important, at a time when American taxpayers rightly insist on careful evaluation of the effectiveness of programs and demand that fraud and abuse be eliminated in entitlement programs for the disadvantaged, it is critical to remember that only audits exert any control over tax expenditures--which are entitlements for the more advantaged in society. Yet, the IRS

is already so strapped that it can perform credits only in very few instances. CBO recently noted in a September 1981 report on tax expenditures, that "[o]nly about 2 percent of returns are audited, however, and many subsidy programs have eligibility rules that rely on information that tax auditors rarely check" (p. xv).

In addition, while it is quickly apparent when spending for an entitlement has increased, since checks are being sent out, unexpected increases can occur in tax expenditures without it being possible to easily determine.

A former Assistant Secretary of the Treasury for Tax Policy and Harvard Law Professor Stanley Surrey noted that:

"...what is beginning to emerge as a crucial matter is the ease with which many legislative issues can become 'tax matters' through a simple restructuring of the suggested solution, and hence fall within the jurisdiction of the tax committee rather than within that of the legislative committees otherwise having jurisdiction over the area...Put another way, the tax committees have the jurisdictional ability to take over much of the legislative field by providing a 'tax answer' to the issue." 5/

This trend can be at least slowed if tax expenditures and direct spending receive comparable budget treatment.

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H.R. 4882 is not asking Congress to take a giant, risky step into the great unknown. Rather, it is a natural progression

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5/ Surrey and McDaniel, "The Tax Expenditure Concept and the Budget Reform Act of 1974", Boston College Industrial and Commercial Law Review, Vol. XVII, No. 5, 679, at p. 711 (1976). (hereinafter cited as Surrey, "The Tax Expenditure Concept")

of a series of steps taken over the last decade and a half to develop better oversight in the tax expenditure area.

The tax expenditure concept began to receive serious governmental attention in the late 1960's. In 1968, the Treasury Department published the first "tax expenditure budget". 6/ It arranged a list of tax expenditures in accordance with direct budget categories and made comparisons with direct spending programs.

Pursuant to a Congressional directive in 1971, similar lists were published in later years by the Congressional tax staff. 7/

Congress took a further step under the 1974 Budget Act by specifically recognizing and defining tax expenditures, and by establishing some requirements they must meet. Thus, once an overall revenue floor is established by the Second Budget Resolution, any legislation to reduce total revenues below the floor is subject to a point of order. Hence, any increase in tax expenditures must compete with all other revenue-losing provisions, including general tax cuts, for the amount of tax reduction permitted by the Resolution. 8/ This is somewhat similar to the control over spending programs provided by overall spending ceilings. As CBO noted:

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6/ Annual Report of the Secretary of the Treasury for Fiscal Year 1968, p. 326-340. See Surrey, "The Tax Expenditure Concept", p. 681.  
 7/ Conference Report on the Revenue Act of 1971, H.R., Rep. No. 708, 92d Cong., 1st Sess. 49 (1971). See Surrey, *supra*.  
 8/ Congressional Budget Office, "Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1982-1986", September 1981 (hereinafter cited as CBO Report)

"While the second budget resolution does include limits on spending by major functional category, spending legislation is not subject to a point of order if it would breach these function-by-function ceilings. It is only the overall spending totals that are binding, just as it is only the overall revenue floor that limits tax expenditures or other tax cuts...it is only the last spending bill that gets caught by the spending ceiling, just as it is only the last revenue-raising bill that gets caught when the revenue floor is reached." <sup>9/</sup>

The Act also requires five-year projections of the estimated levels of tax expenditures by budget function to be included in Budget Committee reports accompanying the First Concurrent Resolution. Committee reports on all bills with new or increased tax expenditures must include five-year estimates of revenue loss.

The tax expenditure budget, listing all tax expenditures and estimated revenue losses, is published by the Executive Branch each year with the President's budget. This is followed several months later by Joint Taxation Committee five-year projections of estimated tax expenditure revenue losses, which are then included in the Budget Committee reports in the First Resolution.

However, the need for action is seen by the fact that the budget resolutions do not set targets for tax expenditures by functional categories as they do for direct spending programs, and the tax Committees are not allocated target ceilings for tax expenditures, as legislative Committees receive for their programs. <sup>10/</sup>

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<sup>9/</sup> CBO Report, p. 51.

<sup>10/</sup> CBO Report, p. 50.

It is this that is required.

But enough material is available to make this additional important step a feasible one.

Congress has made other efforts to control tax expenditures even more directly, as in 1976 when the House and Senate Budget Committees "attempted to exert some control over the level of tax expenditures by providing for a \$1 billion increase in revenues through 'tax reform legislation'". 11/ This effort did exert a significant influence on the tax writing Committees. 12/

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In addition to my general support for H.R. 4882, let me offer the following brief observations.

- Tax expenditures should be classified according to the same functional categories used by the Budget Committees for direct expenditures, to ease synthesis and comparison between the two types of expenditure programs.

- No bill increasing tax expenditures should be considered prior to the First Budget Resolution--the same restriction applied to new budget authority.

- Tax Committees should be required, like all other Committees, to report to the Budget Committees by March 15 of proposals regarding tax expenditures by functional category, so that the Budget Committees could state their assumptions regarding direct

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11/ Surrey and McDaniel: "The Tax Expenditure Concept: Current Developments and Emerging Issues", Vol. XX, No. 2, 225, at 300 (1979). See discussion from 300-327 for other examples.

12/ Supra., p. 306.



and tax expenditures in each category that underlies their overall outlay and revenue recommendations.

- The Budget Committees should be able to set a level of tax expenditures for the tax Committees as they do to the legislative Committees for spending programs.

- Congress should avoid arbitrary or fixed limits on tax expenditures which would bind future Congresses. H.R. 4882 wisely avoids this straight-jacket.

- Serious consideration should be given to incorporating into H.R. 4882 some of the ideas in Senator Kassebaum's bill, S. 193, which provides for a joint referral of new or expanded tax expenditure measures both to the tax writing Committees and to the legislative Committee with jurisdiction over the subject matter covered by the tax expenditure and actual authorization of any new tax expenditure. Strict timetables should be imposed to assure the legislative Committee acts promptly. It is not clear actual passage should be required in the second Committee, but certainly the opportunity for consideration is critical. This joint referral procedure would be a major step forward in achieving some coordinated consideration of direct and indirect spending provisions, of securing the expertise of the legislative Committees into any new tax expenditure, and of requiring a decision as to whether the public policy goal can best be achieved by a direct spending program or a tax expenditure

program--a critical decision now not institutionally possible. 13/

There is already precedent for such a step as legislative Committees have held hearings and issued reports on tax expenditures which cover subjects within their legislative jurisdiction. 14/

- One must be realistic about the ability to easily control any particular tax expenditure on a year-to-year basis. While at least theoretically, a limit can be placed on a direct entitlement program and can be enforced by sending out no more money or a reduced pro rata amount to beneficiaries to enforce the ceiling, this cannot be effectively done with tax expenditures. There the amount any one expenditure will cost the government is not in the government's control, but depends both on economic factors and the number of eligible taxpayers who choose to use the tax expenditure. This is often not known until some time later, after the fiscal year is over and a thorough analysis has been performed.

- Other difficult issues must be tackled such as the method of dealing with refundable tax credits, which have elements of direct and indirect spending.

- Whenever possible, the budget process should be used to encourage the tax writing Committees to exercise greater oversight in the tax expenditure area, and to write new tax expenditures with scheduled expiration dates to permit Congress to evaluate the

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13/ Supra., p. 329, where Surrey and McDaniel suggest such joint referral could already be done in the Senate under Section 3(b) of Rule XXVI of the Standing Rules of the Senate.

14/ Supra., p. 329, p. 308, for examples.

Mr. PEPPER. Thank you very much, Mr. Eizenstat, for your excellent statement.

Are there any questions? Mr. Bonior.

Mr. BONIOR. Yes, thank you, Mr. Chairman.

Thank you for a very thoughtful statement on a relatively complex issue. On page 3, I believe, of your prepared statement [see p. 225] you mentioned the so-called Economic Recovery Act of 1981 would add an additional \$13 billion in tax expenditures for 1982. I think it is important to note there that that number increases geometrically.

Mr. EIZENSTAT. Yes, that is a first-year number. It increases substantially.

Mr. BONIOR. Substantial in the out years. Congressman Gephardt came before us yesterday and I think did a very good job, as you have, in outlining the contradictions of policy with respect to tax expenditures and direct spending programs. Of course the one that you have highlighted on health care is as good an example as any. I think Congress has really never been able to address those contradictions on a side-by-side analysis.

Mr. EIZENSTAT. Neither, by the way, has the executive branch, and again, although they would send up a tax expenditure budget, it was always a physically separate document, and the process that we would go through in budgeting, budget appeal, and so forth, rarely provided any opportunity to measure those two programs side by side and to see whether they were going in the same direction, to see whether we might convert certain of the spending programs in the tax expenditures or vice versa.

Mr. BONIOR. On page 7 of your prepared statement, could you elaborate a little bit on the paragraph in which you talked about tax expenditures, the problems with the Internal Revenue Service? [See p. 229.]

Mr. EIZENSTAT. I think, first of all, what is happening is there is more and more direct pressure on spending programs, as we look for ways to cap spending programs. That doesn't in any way undercut the intensity of need that may exist in a variety of communities, the business community, low-income community, and so forth. They are going to seek other ways to achieve the same result, and the other ways they seek are ways that are, frankly, more invisible, that is, by couching it in terms of a tax reduction.

Now, the Internal Revenue Service likes to think of itself, based on the experience I had in working with the tax policy people in the IRS, as a service which is in business to collect taxes in an efficient mechanism, and to provide answers to taxpayers on how those taxes can be collected, and to audit taxpayers to insure that the law is being enforced.

When it comes to something like an energy tax credit, for example, how do you really know whether or not—and this is a credit, by the way, that I support, but I am just relating it to the problem of proliferation—how do you know that a particular taxpayer has in fact put in the storm windows or the caulking that would qualify for that particular credit? Well, you really don't know in any effective way except through the honesty of the taxpayer who checks a particular box on the form, and the only way we have any effective control over that is the IRS.

Now, if the IRS, as it is, is only able to audit 2 percent of the tax returns, you are just adding to their burden at a time when their own staff is being cut, to tell them that they have to look at more and more items. They simply don't have the capacity, and frankly, they don't have the interest, because they don't view themselves as an energy agency or a housing agency. They view themselves as a tax-collecting agency, and they have a notable lack of enthusiasm for these tax expenditures.

Now, again, I have proposed my share of tax expenditures in 4 years. I think that they can serve useful purposes, but they have to be done carefully and coordinated with direct programs, and they do have to be analyzed as one more item seeking limited Federal resources.

Mr. BONIOR. Last year in the Ways and Means Committee activity report, I think they listed only 10 of the existing 104 tax expenditures, or 92, whatever it was, that were even reviewed, and I suspect that that type of review in the authorizing committee was somewhat on the same scale or perhaps even less.

The difficulty I see ahead in having joint referral on these issues to the authorization committees, of course, is their political problem with a constituency base and the nature of their relations with those committees which they have developed through the years. However, I think at some point it may be a natural evolution out of this whole process.

Mr. EIZENSTAT. If you put the joint referral on a strict time basis, so that, for example, the legislative committee had to report back within a prescribed period of time, then you avoid the possible delay, and at least you give the legislative committee the capacity, which it certainly would not want to exercise in every case, but in important tax expenditure cases, to hold hearings, and to look at whether the same program could be done through a direct spending mechanism, and if not, whether the tax expenditure is likely to achieve the particular policy goal, which is in that committee's jurisdiction, and which the tax expenditure is attempting to achieve.

Mr. BONIOR. I thank you for your support of this proposal and your history showing that this is not a novel problem. This really evolved over a period of 14 years or so, and we appreciate your taking the time to come and help us out.

Mr. DERRICK. Mr. Beilenson.

Mr. BEILENSEN. I have no questions, Mr. Chairman. I thought it was truly excellent and comprehensive testimony and very, very helpful to us.

Mr. FROST. I would echo the sentiments of the others and thank the gentleman for his testimony.

Mr. DERRICK. Stu, we thank you very much for coming.

Mr. EIZENSTAT. Thank you.

Mr. DERRICK. Prof. Paul McDaniel, Boston College Law School. We are delighted to have you before the committee and thank you for taking the time to come and testify. You may summarize your statement or read it, as you choose, and we will put it in the record in its entirety.



STATEMENT OF PROF. PAUL McDANIEL, BOSTON COLLEGE LAW  
SCHOOL

Mr. McDANIEL. Thank you. With your permission, then, I will simply summarize my statement.

H.R. 4882 raises two questions with respect to tax expenditures that I think are equally important. It addresses one issue but does not, and I think should, address the other.

One aspect of tax expenditures is, of course, the aggregate Federal spending that takes place through this mechanism. Since the first tax expenditure budget was produced in 1968, the number of tax expenditure programs has risen from 40 to 104 and the revenue cost has risen from \$44 billion to an estimated \$266 billion in fiscal year 1982.

As another measure of the increase, in 1976 tax expenditures represented 5.7 percent of GNP, and for fiscal year 1982 they will represent 8 percent, of GNP. We have thus had about a 40-percent increase in tax expenditures by that measurement during a period of time in which direct expenditures have actually declined as a percentage of GNP, and may be expected to decline further in light of recent congressional actions.

The question whether the approach in H.R. 4882 deals adequately with this problem of aggregate levels of spending through the tax system is really an issue that can be phrased, I think, in the following way. Tax expenditures are the functional equivalents of entitlement programs. That is to say, the beneficiaries of these programs simply announce that they are qualified for them, take advantage of the benefits, and, if there is a subsequent audit, then it is determined whether or not they are, in fact, entitled to the benefits.

Thus I would pose the question, would an overall ceiling on direct entitlement programs be an effective way of getting direct entitlement programs under control? If your budget experts answer the question yes, that is, that would be an effective way to bring direct entitlement programs under control, then it will be an equally effective way of bringing tax expenditures under control. If budget experts advise that there are some problems with that technique in bringing direct entitlement programs under control, then one should to anticipate that those same kinds of problems are going to be encountered in connection with tax expenditure programs as well.

Having said this, not being a budget expert, it does seem to me that H.R. 4882 represents a useful first step in starting us down the path of bringing aggregate spending through this mechanism under control. But I would anticipate that as Congress has encountered great difficulty on the direct outlay side with entitlement programs, even under the stricter budgetary controls that exist with respect to direct expenditures, I would suspect that there are going to be some problems under the approach of H.R. 4882 with tax expenditures. I would urge that the Congressional Budget Office and others be asked to approach the problem from the following perspective: Assume the tax expenditures are entitlement programs. Will the mechanism of H.R. 4882 work? If modifications



or refinements are needed, what kind of modifications or refinements would be appropriate?

The second aspect of tax expenditures that should be of concern with respect to the budget process is that of adequate evaluation and control. Here the issue is insuring that in times of tight budgetary prospects, the funds being expended through the tax program are efficiently expended, and that there is not unnecessary duplication and overlap with direct expenditure programs.

The 1981 act, I think, gives us ample warning that this second aspect as well as the first aspect are both in serious need of control. With respect to aggregate spending, I estimate that tax expenditures under the 1981 act will increase by about \$266 billion over the next 5 years.

With respect to particularized programs, the problems created by the lack of legislative input from other committees with direct program corresponding to those of tax expenditures was dramatically illustrated by one of the particular tax expenditure programs in the 1981 act, the safe harbor leasing provision.

I am not at all sure that when Congress enacted the safe harbor leasing provisions, it understood that it was enacting a different form of delivering Federal transfer payments through the tax system to a particular class of beneficiaries. But in fact it was doing so. And this action was taken without any review by any committee with appropriate jurisdictional responsibility to ask questions such as why is the program being run through the tax system and is it being run efficiently.

There are some initial indications that this kind of input would have been very helpful before Congress acted on the safe harbor leasing provision. For example, transactions entered into to date seem to indicate that there is a waste element involved in this transfer program of around 30 to 40 percent that arises solely because of the decision to transfer Federal funds to loss corporations through this particular mechanism. That waste element occurs because we have selected profitable corporations to deliver the Federal transfer check to the beneficiaries of the program.

The program works like this. If a loss corporation buys \$1 million worth of equipment, the value of the tax benefits associated with that purchase is on the order of \$320,000. The amount the profit corporation actually pays to the loss corporation is somewhere around \$200,000, a little more or a little less, depending upon the deal worked out. In effect what is happening in this program is that in order to deliver \$200,000 to a loss corporation, which I assume is the objective of Congress, a commission of \$120,000, or about 35 to 40 percent of the total benefits, is being paid to profitable corporations to deliver that benefit.

Now, the question is whether we really have to make that commission payment in order to get the Federal Treasury check to the loss corporations. This is a serious question in a time in which there are going to be scarce direct budget funds available.

The Treasury is estimating that that provision is going to cost around \$29 billion to \$30 billion over the next years. One important question is whether that is a good revenue estimate. But an equally important question is how much of that \$29 billion to \$30 billion is going to get to the intended beneficiaries. My own esti-

mates are that only something on the order of \$16 billion to \$17 billion, maybe \$18 billion is going to get to the intended beneficiaries.

The rest is going to be siphoned off by profitable corporations and by law firms and brokerage firms making the deals. This is a result, it seems to me, that should be of real concern to Congress, because this transfer payment technique is not necessarily confined to safe harbor leasing.

For example, if a Senator or a Congressman were concerned about the cut in the school lunch program or the food stamps program, the simple way to circumvent budget restrictions is to convert food stamps or the school lunch program to a tax credit, and then permit beneficiaries whose tax credit exceeds tax liability to sell the excess credit to high-income individuals to offset against their own tax liability. By this device one would have simply and easily circumvented any attempts to bring those kinds of entitlements under control.

The introduction of this quite new and different form of Federal transfer payments system went disguised in one subsection of a tax bill. Because other committees, accustomed to looking at transfer payment programs directly, didn't get a chance to look at the provision in advance, we now have in place a program which has the capacity for substantial waste, at a time when the Federal Government simply can't afford to be wasting money, at least without substantial cost to other programs.

This program, as Mr. Eizenstat pointed out, is going to go largely unchecked, because it is hidden in the tax system. Direct entitlement programs will be cut, but this one will not have to compete for the available Federal funds because it is run through the tax system.

I would, therefore, in the second aspect of my testimony, endorse Mr. Eizenstat's suggestion. I really think there needs to be added to H.R. 4882 some mechanism by which the necessary evaluation and control over individual tax expenditure programs can be written into the budget process. The failure to utilize efficient tax expenditure programs is as serious a budget problem as is a similar failure in direct outlay programs.

I think a good first step in this respect would be a modification of the proposal by Senator Kassebaum, to require referral of tax expenditures to the appropriate legislative and the budget committees. I think there should be a time limit placed on the referral. I would not preclude Senate or House consideration of the measure in the absence of a favorable report by those committees, as Senator Kassebaum's bill does. I think that the House, the full House and the full Senate, are entitled to the informed views of each of those committees, but I would doubt that it would be desirable to give them, in a sense, a veto, as seems to be present in her bill.

On a longer range basis, ultimately I think the United States must move to a more comprehensive system of bringing tax and direct expenditures under control. We will need, I think, to move toward a system something like that adopted in Canada, whereby an individual department of the Government is given a budget figure which includes both tax and direct spending in its budget area. The aggregate of the department's programs must meet the

target dollar level given to it. It then can reach that level either by reducing tax expenditures or direct expenditures, or by modifying either or both. But the combined total of tax and direct spending must reach the target given to the department.

Ultimately, it seems to me the budget process should require a same approach in Congress. That is to say, the budget resolution should set an overall dollar limit in each functional category, which limit would include both tax and direct expenditures. The appropriate legislative and tax-writing committees would have to work together to reach that target level in each budget function.

That approach I suspect, in light of various committee jurisdictional problems, is a way down the road but it does seem to me it is a direction in which we need to move. I think H.R. 4882 moves us in that direction in terms of aggregates, and I think some modification of S. 193 could move us in that direction in the form of evaluation and coordination.

Thank you very much, Mr. Chairman. I will be glad to respond to questions.

[Mr. McDaniel's prepared statement with attachments follow:]

STATEMENT

of

PAUL R. MCDANIEL  
Professor of Law  
Boston College Law School

before the

House Committee on Rules

in

Hearings on H.R. 4882

December 10, 1981

INTRODUCTION

I appreciate the invitation of the Committee to appear and discuss questions of critical importance to continuing governmental efforts to obtain more effective control over the Federal Budget. These questions involve:

-- In an era of limited Federal resources, how can Congress insure that Federal spending programs run through the tax system represent an efficient use of Federal revenues?

-- In a time when Congress is striving for a balanced budget, how can the largely unchecked spending through the tax system be curtailed?

-- In a decade when the competition for Federal funds can be expected to result in close scrutiny of the need and effectiveness of direct spending programs, how can Congress insure that tax expenditures are subjected to that same evaluation discipline?

The efforts of this Committee to address these questions are both timely and necessary if Congress is to realize its goals of a balanced and efficient Federal Budget.



### I. The Growth of Tax Expenditures

The growth of tax expenditures in recent years leaves little doubt that renewed Congressional attention to this burgeoning area of the Federal Budget is urgent. The initial tax expenditure budget submitted by the Treasury in 1968 revealed some 40 separate programs. By 1976 the number of programs had doubled to 80 and for fiscal 1982, the total is expected to rise to 104. The revenue cost of tax expenditure programs has risen even more dramatically: From a \$44 billion level in 1968, to over \$97 billion in 1976, to an estimated \$266 billion in 1982. Thus, tax expenditures have contributed dramatically to the growth of government since 1968. There has been a 150% increase in the number of programs and more than a 600% increase in revenue costs for tax spending programs. Tax expenditures for fiscal 1982 will equal about 8% of GNP; but in 1976, tax expenditures were only 5.7% of GNP. There has thus been a 40% increase in the percentage of GNP represented by tax spending programs in only six years.<sup>1</sup>

The rate of growth in tax expenditures has substantially exceeded that of direct expenditure programs. For example, in 1976 direct outlays were 22.7% of GNP and that number under President Carter's fiscal 1982 Budget was expected to increase only slightly -- to 23% -- in 1982. Moreover, the trend in direct outlays is actually down, since direct outlays equaled 23.3% of GNP in 1981.<sup>2</sup> Thus, as a percent of GNP, direct expenditures increased only slightly between 1976 and 1982 and, in light of recent Congressional actions, may be on the decline. This record on control of direct expenditures stands in sharp contrast to the unchecked and dramatic increases in tax expenditures as a percent of GNP.

Moreover, the rate of increase in total direct outlays has been substantially less than that of tax expenditures. In 1968, direct outlays totalled \$178.8 billion. In 1976 that figure rose to \$366.4 billion, and in 1982 outlays are expected to total over \$700 billion.<sup>3</sup> Thus, whereas the total of tax expenditures in 1982 is over six times greater than the total in 1968, the total of direct expenditures is only about four times the 1968 total.

By whatever measure, the record clearly establishes that the one element of the total Federal Budget that has been and is out of control is the tax expenditure component.<sup>4</sup>

(See footnotes at end of article.)



II. The Impact of the Economic Recovery  
Tax Act of 1981

A. Overall Effects on Tax Expenditures

The recently passed Economic Recovery Tax Act of 1981 offers some instructive illustrations of the impact of tax expenditures in terms of total Federal spending and in terms of the ability of Congress effectively to control particular spending programs.

-- For individuals, new and expanded tax expenditures of a general nature will total an estimated \$94.7 billion for the five-year period 1982-1986.

-- For business, new and expanded tax expenditures will total an estimated \$149 billion for the five-year period.

-- For savings, new and expanded tax expenditures will total an estimated \$17.9 billion over the five-year period (reductions in tax expenditures in this area will total \$2.5 billion).

Thus, the 1981 Act will add \$261.6 billion to tax expenditure budgets over the next five years from the changes and additions it made to the existing tax expenditures list. (Against this figure may be netted the \$2.5 billion in reduced tax expenditures for savings and, perhaps, the \$1.7 billion revenue gain from changes in the provisions applicable to "tax straddle" transactions).<sup>5</sup>

On the other hand, the total of tax expenditures for individuals will be reduced as the rate reductions for 1982 and 1983 take effect. This phenomenon occurs by virtue of the fact that revenues expended for tax expenditures effected by means of special exclusions from income, special deductions, and special exemptions rise when tax rates are increased and fall when tax rates are reduced. That is, when Congress increases tax rates it automatically increases federal spending through the tax expenditures whose cost is a function of tax rates; correspondingly, when tax rates are cut, Congress simultaneously reduces federal spending programs effected by means of special exclusions, deductions and exemptions.

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(See footnotes at end of article.)

### B. The "Safe Harbor Leasing" Rules

The particular problems that Congress faces when dealing with tax expenditures may be highlighted by focusing in more detail on one of the new tax expenditures created by the 1981 Act -- the "safe harbor leasing" provision included in the new Accelerated Cost Recovery System.<sup>6</sup> The safe harbor leasing rule (SHL) was enacted because the depreciation deductions awarded under ACRS were so excessive that many companies could find themselves in a tax loss position, unable to use currently their investment credits and perhaps even part of the ACRS deduction itself. That result was deemed undesirable by the Administration and Congress, presumably because the permissible carryback and carryover of the excess tax benefits diluted the desired incentive effect of ACRS and the investment credit.<sup>7</sup>

One solution to this issue would have been to have made the excess tax benefits refundable. As to ACRS, the Treasury could have been authorized to deliver a check to a business whose ACRS deductions exceeded income. The check would have represented an interest free loan repayable to the Treasury over a specified time period (corresponding to the fact that accelerated depreciation is the functional equivalent of a direct interest free loan). Likewise, unused investment credits could have been refunded to a "tax loss" business. Since the investment credit is the functional equivalent of a direct Government grant, the business would simply have retained these Treasury funds. Refundable tax benefits are themselves, therefore, the functional equivalents of direct Federal transfer payment programs, such as food stamps, etc.

The SHL rules were viewed as an alternative to the refundability approach. Under SHL, the business receives its Federal transfer or welfare payment by selling its excess tax benefits to a profitable corporation. The program beneficiaries thus receive immediate cash and the profitable corporation reduces or eliminates its Federal corporate income tax by using its acquired tax deductions and credits.

But the SHL approach produces dramatically different results from refundability -- differences which should be of critical concern to Congress.

First, the comparability of SHL to refundable tax benefits makes clear that SHL is simply a method of effecting Federal transfer payments to qualifying businesses. Instead of having the Treasury issue the business

(See footnotes at end of article.)

welfare checks directly to a tax loss company, profitable corporations were selected as the agents to deliver the Federal transfer payments. From a budgetary standpoint, the SHL approach thus introduced an alternative method for implementing Federal transfer payment programs. The important question is whether this alternative method is subject to the same budgetary scrutiny as are the direct transfer payment programs for individuals such as food stamps, Social Security, AFDC payments and the like.

It appears that the SHL method of effecting Federal transfer payments opens a significant loophole in the Budget process. Had the excess ACRS and investment credit benefits been made available to loss businesses through the refundability mechanism, the following Budget results would have occurred:

- The refundable portion of the business benefits would have been funded out of actual taxes paid by profitable corporate taxpayers.
- The refundable portion of the business benefits would have constituted "outlays" for Budget Act purposes and hence would have been subject to the limitations of the Budget Resolutions applicable to all direct outlay programs.<sup>8</sup>
- When reductions in direct outlays were thought necessary, the business welfare outlay programs would have been required to compete with individual welfare programs in the process to establish Congressional spending priorities under a reduced budget.

Under the SHL system of delivering the Federal transfer payments to tax loss companies, the following sharply contrasting results are produced:

- Profitable corporate taxpayers are not required to pay any corporate taxes to help fund the business welfare programs.
  - The transfer payments do not constitute "outlays" under the Budget Act,<sup>9</sup> and hence are not subject to any limits on Federal "outlays" in the Budget Resolutions; moreover, since profitable corporations are not required to pay any tax under the SHL approach, they are exempted from contributing to revenue goals established by the Budget resolution and thus all revenues must come from taxes imposed on bases other than corporate profits.
  - When reduction in Government outlays are thought desirable, the SHL approach completely exempts the transfer payments to business from the discipline of establishing priorities among existing Federal
- (See footnotes at end of article.)

transfer programs; as a result the only transfer programs subject to reduction are those for individuals which are paid by actually issuing Government checks.

The potential Budgetary danger of the SHL approach for delivering Federal transfer payments can be illustrated by the following example. Assume that the food stamps program was converted to a "food stamps tax credit." Those eligible for the tax credit would then be permitted to sell their credits to higher income individuals to the extent the allowable credits exceeded tax liability. The purchasers could then reduce their individual income tax liability by using the acquired tax credits. By this simple technique the food stamps program could be removed almost entirely from the controls of the Congressional Budget process.

Congress thus urgently needs to scrutinize the SHL provisions with particular attention to questions such as the following:

- In times when Federal transfer payment programs must be reduced because of limited budget resources, why is the business transfer payment program exempted from any reductions so that the entire burden of program cuts must be borne by transfer programs that benefit low-income and elderly individuals?
- In general, is it desirable virtually to exempt a Federal transfer program from the Budget process simply because a different method for delivering the program payments is adopted?
- More broadly, why is the Federal government now employing a "two-track" transfer payment system, one for individuals and one for business?

The SHL system also raises another question with which Congress must be concerned. In an era of limited Federal resources, it is vital that Federal transfer payment programs operate as efficiently as possible. Thus, the SHL technique must be examined closely to see if it is cost-benefit effective. That is if the objective is to provide Federal payments to ailing businesses, is \$1 of Federal revenue cost translated into \$1 of benefit to the program beneficiary? In recent public discussions of SHL, attention appears to have focused exclusively on the question whether the estimated revenue losses from SHL will exceed those anticipated at the time of enactment.<sup>10</sup> This is a valid and important question for Congress to consider, but it is not the only question.

(See footnotes at end of article.)

Under the SHL system, profitable corporations are in effect designated as the agents to deliver the Federal transfer payments to loss corporations. The preliminary indications are that these delivery agents are siphoning off a substantial "commission" to compensate themselves for acting as delivery agents. This fact is readily apparent from an example that appeared in the recent explanation of the SHL provisions issued to the Staff of the Joint Committee on Taxation.<sup>11</sup> (See Appendix A.)

The JCT example assumed that X Corporation purchased equipment for \$1 million. X Corporation sold those tax benefits to Y Corporation for \$200,000 in a "sale-leaseback" transaction. The net present value to Y Corporation of the investment credit, ACRS depreciation deductions, interest expense deduction and rental income equalled \$321,000. Thus, Y Corporation in effect received a \$121,000 "commission" from the Treasury for delivering a \$200,000 Treasury check to X Corporation. Or to put the matter another way, it cost the Treasury \$1.60 to deliver each \$1 dollar of transfer payment to X Corporation. Put still differently, if the objective is to deliver \$200,000 to X Corporation, the Treasury could have saved \$121,000 by just issuing the check itself (e.g., through a refundability mechanism). Or still differently, if the objective is to get \$321,000 of tax benefits to X Corporation, almost 40% of that amount was wasted because of the delivery mechanism selected.

The JCT example appears closely to reflect the realities of what is occurring in the SHL market. In general, the net present values of tax benefits for equipment appear to range from 30 to 37% of the cost of the equipment. But the prices being paid for those benefits appear to range from 16-28% of the equipment costs.<sup>12</sup>

Congress urgently needs to examine the efficiency of the SHL system in carrying out its obligation to insure that limited Federal funds are being expended in the most efficient manner. Attached as Appendix B to this statement are reports of SHL transactions that have appeared in the Wall Street Journal. In most instances, the reports provide the total cost of the equipment and the amount paid by the purchaser of the tax benefits. The amounts paid for the tax benefits in these examples appear to total over \$1.6 billion. Congress should require the Congressional Budget Office and the Staff of the Joint Committee on Taxation to estimate in present value terms the actual total revenue cost to the Treasury of these

(See footnotes at end of article.)



transactions. It can be anticipated, based on the foregoing, that the cost to the Treasury substantially exceeds the \$1.6 billion in transfer payments received by the selling corporations. Congress then needs to consider whether the "commission" or "waste" element inherent in SWL can be tolerated under present budgetary conditions, especially given the fact that mechanisms exist even within the tax system to deliver the transfer payments without the waste or commission element that is present in the SWL mechanism.

The experience with tax expenditures under the 1981 Act is thus illustrative of the fact that this form of Federal spending is still largely outside effective control under the existing Congressional Budget process. Aggregate spending through the tax expenditure mechanism will continue to escalate even as Congress painfully seeks to bring direct spending under control. And the requisite Congressional scrutiny to test individual tax expenditure programs for need, efficiency and cost effectiveness is simply not being undertaken before tax spending programs are enacted.

### III. Efforts Under Existing and Proposed Procedures to Control Tax Expenditures

H.R. 4882 proposes a new approach to try to bring the tax expenditure component of the Budget under more effective control. Before evaluating H.R. 4882 it is instructive to place that proposal in the context of previous efforts and proposals in Congress to exert greater control over tax expenditures.

#### A. The Experience Under Existing Procedures

Since the 1974 Budget Act formally subjected tax expenditures to the Budget process, a number of efforts have been made under existing Act procedures to control aggregate and individual tax expenditures. The following discussion briefly summarizes those efforts and evaluates the results of the experience to date.<sup>13</sup>

In the fiscal 1976 and 1977 Budget Resolutions, the Senate Budget Committee Reports contained language which required that the applicable revenue figure in the Budget Resolutions be reached in part by specified dollar reductions in existing tax expenditures. The Revenue Act of 1976 provided a test for the effectiveness of this procedure. An initial problem with the Budget Committee approach was that the required reduction in tax expenditures was not specified in the Budget Resolution itself.

(See footnotes at end of article.)

Moreover, the Budget Act process itself proved unable to prevent passage of an avalanche of tax expenditures on the Senate floor which were completely at variance from the assumptions underlying the Budget Resolution. Nonetheless, in the Conference Committee deliberations on the 1976 Revenue Act, the Budget process discipline appeared to reassert itself and the resulting reductions in tax expenditures were not far short of the reductions sought by the Senate Budget Committee. The 1976 experience revealed two major lessons with respect to the use of Budget Act processes to control tax expenditures: (1) The required action with respect to tax expenditures would have to be spelled out in the Budget Resolution itself; and (2) Budget Act procedures standing alone could not prevent Senate floor adoption of tax expenditures which were inconsistent with the Budget Committee assumptions concerning the treatment of tax expenditures.

In 1975, repeal of part of the tax expenditures for the oil industry -- the percentage depletion deduction -- was achieved by a Senate floor amendment to the Budget Resolution to require increased revenues. However, in 1977, Senate proponents of tax expenditures for education costs used the same procedure to amend the Budget Resolution to provide revenues adequate to fund a tuition tax credit program. Thus, attempting to control tax expenditures by individual floor amendments to the Budget Resolution does not seem likely to represent a real solution to the problem. Applied neutrally, the procedure is at least as likely -- perhaps more likely -- to result in increased rather than decreased tax expenditures. In either event, the procedure is really antithetical to the Budget Act process since the Budget Resolution is not intended to require specified action with respect to particular spending programs, whether those programs are in the form of direct outlays or tax expenditures.

The Budget Resolution for Fiscal 1979 again dealt with the tuition tax credits. During 1978, Congress adopted the Tuition Tax Credit Act of 1978, but at the same time also approved a competing program of direct education benefits proposed by President Carter. The Budget Committees attempted, through the Budget Act process, to force Congress to choose between one of the two approaches. While only the direct spending approach was adopted, that result occurred only because of the failure of the House and Senate to agree on the scope of a tuition tax credit, not because the Budget Act process had succeeded in forcing Congress to make a choice

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(See footnotes at end of article.)

between two alternative approaches to education subsidies. The Budget process as then and presently constructed simply does not contain the sanctions necessary to enable the Budget Committees to require that choice.

The Budget Act process somewhat accidentally aided in controlling the expansion of tax expenditures during the Senate consideration of the Revenue Act of 1978. Initial floor amendments considered by the Senate used up the revenue "room" available under the 1979 Budget Resolution; cloture was then invoked and most other tax expenditure amendments became subject to a point of order. The 1978 combination of Budget Act rules and cloture is not likely to represent a long-term solution to control of tax expenditures. In this first place, the Senate is not likely to vote cloture with respect to most tax bills. But even if it were to do so, the resulting process is inherently disorderly and irrational. Since Senate floor amendments are generally taken up in no predetermined order only those tax expenditure amendments — whether constituting increases or reductions — that are brought up for consideration prior to reaching a combination of Budget Resolution limits plus cloture can be considered. The resulting race for Senate floor consideration by Senators with amendments affecting tax expenditures does not appear likely to produce systematic and effective control over Federal spending through the tax system.

From time to time, those favoring reductions in particular tax expenditures have offered amendments coupling reductions in tax expenditures with a provision to use the resulting increased revenues to provide a general corporate or individual rate reduction or to provide funds for direct spending programs. Congressional procedures make it difficult to a vote on the combined package and the result has usually been adoption of the tax cut, but rejection of the proposed reduction in tax expenditures.

Finally, the "reconciliation" procedure adopted in 1980 did effectively produce a reduction in certain tax expenditures.<sup>14</sup> It is not clear, however, whether the reconciliation procedure is one that can be adopted every year. Moreover, the reconciliation procedure itself only required the tax-writing committees to increase revenues by a specified amount. That result can be achieved by the tax writing committees by tax increases, by reduction in tax expenditures, or a combination of the two. There is thus little guarantee that the reconciliation process, even if regularly used, will be able to effect systematic control over tax expenditures.

(See footnotes at end of article.)

B. Proposals to Subject Tax Expenditures  
to More Effective Controls

As the above discussion indicates, the existing Budget process cannot adequately control spending through the tax system. The Budget Act itself only requires: (1) A tax expenditure budget to be submitted by the President; (2) Inclusion in the Budget Committee reports of five-year projections of tax expenditures by budget function; and (3) Inclusion in all committee reports of five-year projections for new or increased tax expenditures provided by the bills which the reports accompany. The use of extra-Budget Act procedures to control tax expenditures has been only sporadically and partially successful. This unsatisfactory situation has led to proposals which would subject tax expenditures to more careful scrutiny and which would provide for a greater coordination of tax and direct spending programs in the same budget function category. The principal proposals of this type are briefly outlined in the following discussion.

It should be noted at this point that the Budget Resolutions may provide one indirect control on tax expenditures. The Second Budget Resolution does establish a revenue floor which must be met. The revenue floor, once established, cannot be breached by revenue reduction measures, whether in the form of a general tax cut or by adding new or increased tax expenditures. The problem has been that generally the revenue floor is established after it is apparent what direction Congress has taken or will take with respect to new or expanded tax expenditures. Thus, the floor too often has been a reflection of tax expenditure actions already taken, or contemplated, rather than serving as a barrier to new or expanded tax expenditures. Up to the point of the adoption of the Second Budget Resolution, the revenue figure in the First Budget Resolution is simply a target, and it can be met by general tax increases or reductions as well as by increases or decreases in tax spending.

One approach to exerting greater Congressional control over tax and direct spending has been embodied in the "sunset" legislation which has been considered by Congress over the past five years. This legislation would subject Federal spending programs to periodic review and evaluation, with termination of a program to occur in the absence of an affirmative Congressional vote to extend it. It is readily apparent that if the sunset approach is to be effective, it must be equally applicable to tax and direct spending  
(See footnotes at end of article.)

programs.<sup>15</sup> Congress is not yet satisfied that the sunset approach is feasible and it thus appears doubtful at this time whether that approach offers a likely avenue to achieve greater control over tax expenditures.

On occasion, Congress has written a sunset requirement into individual tax expenditure provisions by placing a time limit -- usually five years -- on the availability of the provision.<sup>16</sup> Experience to date has not provided much assurance that the contemplated review and evaluation of the tax expenditure in fact results from the sunset provision. Too often, Congress has merely extended the provision -- sometimes even retroactively -- without requiring the studies and data necessary to evaluate carefully the tax expenditure program.

In recent years, others have proposed to control government spending by limiting expenditures to a specified percentage of GNP. Again, analysis has shown that such a limitation is meaningless unless it applies both to tax and direct expenditure programs.<sup>17</sup> However, Congress has not seen fit to adopt this relatively crude approach to spending control generally and it thus seems doubtful that tax expenditures will be controlled by such a mechanism.

Congressman Daschle recently introduced a resolution to require reductions in tax expenditures proportionate to the reductions being made in direct spending programs.<sup>18</sup>

One issue presented by tax expenditures which none of the above proposals have addressed is the necessity to coordinate tax and direct spending programs in the same-budget function. This problem led Senator Kennedy in 1978 to propose that any bill reported by the Senate Finance Committee which contains or extends a tax expenditure, or any such floor amendment offered by, on behalf of, or with the approval of the Finance Committee, would have to be referred to the Appropriations Committee before it could be considered on the Senate floor.<sup>19</sup> Senator Biden, moving along similar lines, has introduced S.582 to require authorizing legislation for any new tax expenditure such as that required for direct spending programs.<sup>20</sup>

S.193 introduced earlier this year by Senator Kassebaum,<sup>21</sup> proposed a two-part approach to enable Congress more efficiently to control tax expenditures.

(See footnotes at end of article.)



First, the bill would amend the Budget Act to provide that the revenue loss from tax expenditures cannot exceed 30 percent of the recommended level for net revenues set forth in the applicable Budget resolution.<sup>22</sup>

Second, the bill would require (1) that all legislation enacting new tax expenditures, or modifying existing tax expenditures, be authorized by the committee with legislative jurisdiction over the activity affected by the proposed tax expenditure legislation; (2) such tax expenditure legislation must also be referred to the Budget Committee and be reported favorably by that Committee; and (3) any such tax expenditure legislation must be reported to the House or Senate by May 15. (The foregoing requirements would be subject to waiver under section 402(c) of the Budget Act.)<sup>23</sup>

In evaluating the first part of S.193, it is necessary to answer the following question: Would a similar limitation imposed on direct entitlement programs represent sound budget policy? It is essential for Congress to get an answer to this question from its budget experts, because if a proposal to limit direct entitlement programs to a percentage of revenues is unsound as a budgetary matter, then it is likely to be equally unsound as a method of limiting tax expenditures. Conversely, if such a limitation would constitute a sound measure, from a budget policy perspective, of limiting direct entitlement programs, then a limitation on tax expenditures such as that proposed in S.193 would appear appropriate also. Of course, if the approach suggested by S.193 is sound budget policy, it could be adopted for tax expenditures without applying it to direct entitlement programs.

The reason why the limitation approach of S.193 must be tested in terms of its applicability to direct entitlement programs is that virtually all -- indeed, perhaps all -- tax expenditure programs are drafted as the functional equivalents of entitlement programs. That is, in tax expenditure programs, Congress establishes program eligibility criteria which, if the taxpayer claims are met, automatically entitles the program beneficiary to the benefits. This approach parallels that of direct entitlement programs such as food stamps, Medicare, etc. As in the case of direct entitlement programs, tax expenditure benefits are paid out before the Government audits the beneficiary's actual entitlement to the funds.

(See footnotes at end of article.)

With the foregoing analytic technique, it is possible to test preliminarily the efficacy of the percentage limitation approach proposed in S.193. Assume that the S.193 approach were applied to limit direct entitlement programs to 30 percent of net revenues. Assume further that Federal revenues in fiscal 1982 were estimated to be \$700 billion. For fiscal 1982, therefore, total outlays for entitlement programs could not exceed \$210 billion. If revenues for fiscal 1983 rose to \$800, entitlement programs could rise to \$240 billion without violating the limitation. This result raises the question whether there is a sufficiently rational relationship between direct entitlement program levels and revenues to warrant using revenues as the base figure. Obviously, in the above example, Congress might prefer that entitlement programs receive in excess of 30 percent of the added revenues in 1983. It might alternatively desire that less than 30 percent of the added revenues go to direct programs and here the danger might be that the 30 percent ceiling in fact would prove to be a floor as well.

The same issues must be faced in applying a limitation to tax expenditures based on revenues. Just because revenues go up by \$100 billion, why should tax expenditures be permitted to rise by \$30 billion? In short, does Congress really wish to commit itself to the proposition that as much as 30 percent of revenues can be expended via the tax expenditure mechanism?

There are thus three related questions which Congress must consider: First, does an aggregate limitation technique represent a sound budgetary approach to limiting Federal spending, whether tax or direct? Second, if so, is a limit computed with reference to net revenue the most desirable base or would another base, such as GNP, produce more rational results? Three, would a dollar limit on tax expenditures, expressed in the Budget Resolution represent a more effective limitation technique?

The procedural changes proposed in the second part of S.193 would represent a significant advance in the ability of Congress more effectively to control the aggregate level of tax expenditures, to devise more efficient programs where the tax route is followed, and to coordinate tax and direct spending programs. Under present procedures, the tax writing committees act as both the authorizing and the appropriations committees when they approve new or increased tax expenditures. The necessary checks simply are not present to determine whether a tax expenditure program is duplicative of or

(See footnotes at end of article.)

even consistent with direct programs in the same area. The procedure proposed in S.193 would enable the appropriate legislative committees to make the necessary program evaluation and coordination decisions and the Budget Committees would be able to exert greater pressure to prevent unnecessary and undesirable duplication of costs. The sequential referral procedure in S.193 would represent, therefore, a very positive step forward in more effective Congressional budget control.

#### C. Lessons from the Experience to Date

The above sketch of efforts since the enactment of the 1974 Budget Act to bring tax expenditures under more effective control lead to the following conclusions:

1. The present procedures under the Budget Act are inadequate to insure that tax expenditures will be subject to the same budgetary discipline as exists with respect to direct spending programs.
2. Ad hoc procedures available outside the Budget process offer little prospect for rational and effective Congressional control of tax expenditures.
3. There is no existing procedure which provides the coordination between tax and direct spending programs which is necessary to avoid wasteful program duplication and inefficient, even counter-productive, expenditures of federal funds through the two forms of spending.

It is against this backdrop of experience and analysis to date that the suggested changes in H.R. 4882 may be considered.

#### IV. The Approach of H.R. 4882

H.R. 4882<sup>24</sup> would amend the Budget Act to require that the Congressional Budget Resolutions fix the level of tax expenditures for each fiscal year.<sup>25</sup>

A limitation such as that proposed by H.R. 4882 is essential if the efforts of Congress to control direct spending and credit programs are not to be undermined through the use of tax expenditures. Many tax expenditure programs are the functional equivalents of direct spending programs. Accordingly, the recommended level of total outlays in the Budget Resolutions can easily be circumvented by redrafting a proposed direct outlay program, which cannot be considered because it would breach the outlay limit established in the Budget Resolutions, as

(See footnotes at end of article.)

a tax credit. As a result, although the tax credit would have precisely the same effect on the Budget as a direct outlay program, the tax credit approach could be adopted whereas the direct outlay approach could not (assuming, of course, that the revenue floor established in the Budget Resolutions was not thereby breached). Similarly, recent Budget Resolutions have attempted to exert greater control over Federal credit programs. Many tax expenditure programs are the functional equivalents of interest-free loan programs, in effect, government credit programs run through the tax system. Again, while the Budget Resolutions seek to exert greater control over direct credit programs, the use of the tax expenditure mechanism to effect federal loans is unchecked. The approach recommended by H.R. 4882 thus represents a necessary step in the evolution of the Congressional Budget process if Congress realistically is to assert control over all types of federal spending.

The term "level of tax expenditures" is not defined in H.R. 4882. Presumably, the figure is to be arrived at by adding the revenue cost of each of the items in the tax expenditure budget published annually by the Congressional Budget Office.

The CBO annual reports on tax expenditures have each noted that there is a factor in totaling tax expenditures which needs to be recognized. The revenue estimate for each tax expenditure is arrived at by assuming that it alone is repealed and all other provisions remain constant. However, there is an interaction effect which needs to be considered. The 1981 CBO report on tax expenditures, for example, states:

"If three or four tax expenditures that take the form of personal deductions did not exist, for example, more people would use the standard deduction (zero bracket amount), and the net cost would be less than if each deduction was considered separately. The standard deduction would absorb part of the cost that would otherwise be assigned to the tax expenditures. On the other hand, if three or four tax expenditures that took the form of exclusions from income no longer existed, more income would be taxed at higher marginal rates, so that the cost would be more than if each exclusion were considered separately."<sup>26</sup>

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(See footnotes at end of article.)

At present, apparently the CBO is unable to estimate which of the two counter effects is the greater.

The question which this interaction effect raises is whether it should preclude the use of a figure which is the sum of particular tax expenditure items as the "level of tax expenditures" figure required in H.R. 4882. I believe it should not. The same interaction effect does occur in totalling direct outlays. For example, repeal of one welfare program may not reduce total outlays by the amount associated with the repealed program. This result occurs if benefits under the repealed welfare program must be counted in determining an individual's eligibility under another welfare program. Repeal of one program could cause more people to become eligible for the other and total government outlays would increase for the program continued. Government outlays would then not be reduced by the full outlay figure shown in the Budget for the repealed program. To put the matter another way, it is not the purpose of budget revenue figures to show the amount of revenue that would be gained if the program were repealed. It is the purpose of budget revenue cost figures to show the actual cost of the existing program. That function is performed by the tax expenditure budget, just as is true in the case of the budget for direct outlays. Thus, if one believes that it is useful to total individual direct outlay programs (while recognizing that the repeal of any one program might not produce a net revenue gain equal to the revenue cost shown for the program), it is equally valid to total the sum of particular tax expenditure programs (again, recognizing the same difference between costs of the program and revenue gained by repeal).

The term "level of tax expenditures" also raises the issue whether only the tax expenditures in the income tax should be taken into account or whether tax expenditures in other federal taxes should be included. If the approach of H.R. 4882 is adopted, CBO should be instructed to prepare an official tax expenditure list for the estate, gift and generation-skipping taxes so that total federal spending through the tax system would be included.

The basic approach of H.R. 4882 can therefore be implemented and it would represent a desirable step forward in enabling Congress to control aggregate spending through the tax expenditure mechanism.

(See footnotes at end of article.)



However, it must be recognized, that H.R. 4882 does not address itself to the equally pressing problem presented by the lack of coordination of tax and direct expenditure programs which are targeted toward the same objectives. The joint referral approach, proposed in S.193, discussed above, addresses this problem. And, if the objectives of H.R. 4882 are to be fully realized, it does appear that a similar approach should be incorporated in it. For example, it would be desirable if all new or expanded tax expenditure provisions approved by the tax writing committees were referred to the appropriate legislative committees and to the budget committees for their consideration. The committees to which the tax expenditure legislation was referred could then be given a time period within which they were to report favorably or unfavorably on the tax expenditure changes. Such a procedure would give the House and the Senate the requisite program evaluations and budget information needed to vote intelligently on proposals to expand existing or implement new tax expenditure programs.

In sum, control of aggregate federal tax spending along the lines suggested by H.R. 4882 is essential to effective Congressional control over total federal spending. However, it should be amended to provide that the necessary program evaluation and coordination with direct spending is undertaken before new or expanded tax expenditures are adopted.

#### V. Toward More Comprehensive Control and Coordination of Tax and Direct Spending

While H.R. 4882 is a welcome sign of renewed interest in bringing tax expenditures under more effective control, it still does not appear to provide a sufficiently comprehensive framework within which Congress may deal with the related problems of controlling aggregate spending through the tax system and coordinating tax and direct spending programs. While this is not the occasion to discuss such a framework in depth, I should like to propose for the Committee's consideration the outline of changes in the budget process which I believe offer prospects for fruitful study:

1. The Budget Act should be amended to require that the President's Budget include both the tax and direct spending totals  
(See footnotes at end of article.)

proposed for each budget function. The Congress is, after all, only part of the Budget process. The Executive Branch must be required to exert its responsibility to control and coordinate both types of spending. What is needed is for the President, through the Office of Management and Budget, to give each Executive Branch Department and agency a budget target which it must meet. And that target must be met by totalling both the direct spending programs for which the Department is responsible and the tax expenditures for programs that are in its area of responsibility. For example, the Department of Education should be assigned a spending target which it could meet (1) by reducing direct spending, tax expenditures for education or a combination of both; (2) by substituting one form of spending for the other; and/or (3) by restructuring either form of spending program to make it more cost-effective. Such a procedure would force non-tax Departments and agencies to take much greater responsibility for tax expenditures than presently is the case.<sup>27</sup> While Congress may not desire to force this procedure on the Executive Branch, a requirement that the Budget be submitted in the form suggested above should move in the desired direction.

2. A similar procedure should be adopted for use by Congress in its own Budget process. The Budget Act should be amended to enable the Budget Committees in the Budget Resolutions to set spending ceilings for the various budget functions which include both tax and direct spending. The appropriate legislative committees and appropriations subcommittees would then have to work with the tax writing committees to insure that combined tax and direct spending for a particular function did not exceed the ceiling. Such a procedure would insure that more rational decisions are made concerning whether and to what extent the tax spending or the direct spending route should be taken. The aggregate of both types of spending could be more effectively controlled. And, as the tax-writing and legislative committees worked together, overlapping tax and direct spending programs could be more readily identified and coordinated.

I fully realize that working out the practical operation of the above proposals would involve adjustments in Congressional Committee jurisdiction. Nonetheless, such an approach appears essential if the American public is to be given the assurance to which it is fully entitled — that the Federal Government is in

(See footnotes at end of article.)

fact spending available revenues in the most effective way possible. That objective simply cannot be achieved if the Executive Branch and Congress look only at 75% of total Federal spending run through direct programs and ignore the other 25% run through the tax system. H.R. 4882 moves to fill that vacuum and deserves support. But it must also be recognized that ultimately more comprehensive approaches must be given the necessary study and consideration.

#### NOTES

1. Figures in the text were derived from Congressional Budget Office, Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1982-1986 (Sept., 1981) Table 1, pp. 34-35 (hereafter referred to as "1981 CBO Report"); Tax Foundation, Facts and Figures on Government Finance (20th Biennial ed., 1979) at 33 (hereafter referred to as "1979 Tax Foundation").
2. Budget of the United States Government, Fiscal Year 1982 at 22, 612.
3. Id.
4. Concern over this phenomenon has been expressed in recent months both in and out of Congress. See, e.g., Statements of Senator Baucus, 127 Cong. Rec. S1590, S1811, and S2078 (daily ed. Feb. 26, Mar. 5, Mar. 12, 1981); Editorial, The Washington Post, "The Other Kind Of Spending," Apr. 3, 1981, p. A14; Rowan, Where To Make Cuts: Start With Tax Shelters, The Washington Post, Mar. 19, 1981, p. A23.
5. The text figures are derived from Staff of The Joint Committee on Taxation, Summary of H.R. 4242, The Economic Recovery Tax Act of 1981 (Jt. Comm. print, Aug. 5, 1981) Table 2, pp. 58-63. It is unclear to what extent the revenue losses from tax straddle transactions were included in prior tax expenditure budgets.
6. I.R.C. §168(f)(8).
7. See The Senate Finance Committee Report on the 1981 Act, S. Rep. No. 97-144, 97th Cong., 1st Sess. 61-63 (1981).

8. Office of Management and Budget, Special Analysis C, Budget of the United States Government, Fiscal Year 1982 at p. 224, applying the *text analysis* to the refundable portion of the earned income credit.
9. The cost of the SEL program is treated as a revenue reduction; see id. as to the nonrefundable portion of the earned income credit.
10. See e.g., Wall Street Journal, Nov. 19, 1981, p. 6.
11. Joint Committee on Taxation, Safe Harbor Leasing Provisions Under Accelerated Cost Recovery System (Oct. 20, 1981) Appendix I.
12. See the examples in Appendix A, which have appeared in The Wall Street Journal.
13. More extensive discussions of the examples discussed in the text are contained in Surrey and McDaniel, The Tax Expenditure Concept and the Budget Reform Act of 1974, 17 B.C. Ind. & Comm. L. Rev. 679 (1976); Surrey and McDaniel, The Tax Expenditure Concept: Current Developments and Emerging Issues, 20 B.C.L. Rev. 225 (1979).
14. See 1981 CBO Report at 51-53.
15. McDaniel, Institutional Procedures for Congressional Review of Tax Expenditures, 8 Tax Notes 659 (1979).
16. See 1981 CBO Report at 55-57.
17. McDaniel, Tax Expenditures and Federal Spending Limitations, 10 Tax Notes 475 (1980).
18. See Statement of Representative Daschle, 127 Cong. Rec. H8177 (daily ed., Nov. 5, 1981).
19. S. Res. 326, 95th Cong., 1st Sess. (1977).
20. See Statement of Senator Biden, 127 Cong. Rec. S1623 (daily ed., Feb. 26, 1981).
21. S.193, 97th Cong., 1st Sess. (1981); Statement of Senator Kassebaum, 127 Cong. Rec. S553 (daily ed. Jan. 22, 1981). A Hearing on S.193 was held by the Senate Budget Committee on November 24, 1981.

22. S.193, 97th Cong., 1st Sess. (1981) 882-5.

23. Id. 86.

24. H.R. 4882, 97th Cong., 1st Sess. (1981).

25. It is arguable that the requisite statutory authority for such a limitation presently exists by virtue of §301(a)(6) of the Budget Act which provides that the First Budget Resolution shall contain not only the recommended levels of revenues, etc., but also "such other matters relating to the

Budget as may be appropriate to carry out the purposes of [the Budget] Act."

26. 1981 CBO Report at 7-8.

27. The proposal described in the text should mitigate the all too frequent practice of non-tax Departments indiscriminately supporting tax expenditures because they are at the limits of their allocable share of direct outlays.

The system described in the text parallels the "envelope system" presently employed in Canada. See The New Expenditure Management System, A Paper Outlining the Envelope System for Allocating and Controlling Expenditures of the Government of Canada (December, 1979).



## APPENDIX A

## NUMERICAL EXAMPLE OF SALE-LEASEBACK UNDER PRESENT LAW

Parties: *Corporation X*, the nominal lessee, which expects to have no income tax liability in future years. *Corporation Y*, the nominal lessor, which expects to have income taxable at a 46-percent rate.

*Agreement*

1. X purchases new equipment having a 10-year ADR life for \$1 million.
2. X sells the asset to Y for \$1 million. Y pays X \$200,000 cash and an \$800,000 note. The note is for 15 years (150 percent of ADR life) at 15 percent annual interest and is paid in equal annual installments of \$136,300 (that is, a level payment loan).
3. Y leases the equipment to X for 15 years and charges an annual rental of \$136,300, which exactly offsets the debt service. Thus, the only money which changes hands between X and Y is \$200,000 from Y to X.
4. At the end of the lease, Y sells the equipment to X for \$1.

*Results*

1. X purchases a \$1 million asset for \$800,000.—(X's rental payments and receipt of loan payments do not affect cash flow—because they are offsetting—or tax liability—because X is not in a taxable position.)

2. Y purchases for \$200,000 tax savings worth more than \$200,000.—Y's tax savings year by year are shown below. Y has deductions for depreciation (column 2) and interest paid (column 3), and it has rental income (column 4). Y's net deduction and tax change are shown in columns 5 and 6, respectively. The present value of this stream (discounted at the after-tax rate of 8.1 percent, which corresponds to a pre-tax rate of 15 percent) is \$321,000. Thus, by paying \$200,000 to X, Y pays \$321,100 less in tax, a gain of \$121,000 in constant (present) dollars.

Another way to express Y's gain is as follows. If Y had purchased at par a 15-year, 15-percent bond for \$200,000, then Y would have (net of tax on interest income) \$643,300 after 15 years. On the other hand, if Y invests the tax savings of column 6 at 15 percent, then Y would have (net of tax on interest income) \$1,032,700 after 15 years, a gain of \$389,400 in comparable (future) dollars.

## BENEFITS AND COSTS OF LEASING TO Y

[In thousands of dollars]

| End of year | Deductions   |               |               |        |                     |
|-------------|--------------|---------------|---------------|--------|---------------------|
|             | Depreciation | Interest paid | Rental income | Net    | Change in tax       |
| 0           | 150          | 0.0           | 0.0           | 150.0  | <sup>1</sup> -169.0 |
| 1           | 220          | 120.0         | 136.8         | 203.2  | -93.5               |
| 2           | 210          | 117.5         | 136.8         | 190.7  | -87.7               |
| 3           | 210          | 114.6         | 136.8         | 187.8  | -86.4               |
| 4           | 210          | 111.2         | 136.8         | 184.4  | -84.8               |
| 5           |              | 107.4         | 136.8         | -29.4  | 13.5                |
| 6           |              | 103.0         | 136.8         | -33.8  | 15.6                |
| 7           |              | 97.9          | 136.8         | -38.9  | 17.9                |
| 8           |              | 92.1          | 136.8         | -44.7  | 20.6                |
| 9           |              | 85.4          | 136.8         | -51.4  | 23.7                |
| 10          |              | 77.7          | 136.8         | -59.1  | 27.2                |
| 11          |              | 68.8          | 136.8         | -68.0  | 31.3                |
| 12          |              | 58.6          | 136.8         | -78.2  | 36.0                |
| 13          |              | 46.9          | 136.8         | -90.0  | 41.4                |
| 14          |              | 33.4          | 136.8         | -103.6 | 47.6                |
| 15          |              | 17.9          | 136.8         | -119.0 | 54.7                |

<sup>1</sup> Includes regular investment tax credit of \$100,000. Lease is executed at end of taxable year.

## APPENDIX B

[From the Wall Street Journal, Nov. 13, 1981]

In recent weeks, General Electric Credit Corp., a unit of General Electric Co., has committed about \$250 million for tax breaks on more than \$1 billion of equipment that it will lease back to a number of companies. That equals the value of equip-

ment GECC, one of the nation's largest leasing companies, put under lease for all of 1980. "We are kind of staggered," says Gary C. Wendt, vice president and general manager of GECC's commercial and industrial financing division.

In the biggest transaction disclosed so far, International Business Machines Corp. bought as much as \$200 million in tax benefits from loss-ridden Ford Motor Co., and nearly \$100 million from CSX Corp., a profitable railroad that has more tax credits than it can use this year. IBM also is buying \$60 million of credits from B.F. Goodrich Co., and earlier had arranged to buy some from Pacific Southwest Airlines, a unit of PSA Inc. PSA had indicated that its gain would be about \$9 million.

#### IC INDUSTRIES

IC Industries Inc. said it sold the tax benefits on equipment valued at \$93 million from its Illinois Central Gulf Railroad Unit for about \$28 million. The buyer wasn't disclosed.

#### PACIFIC SOUTHWEST AIRLINES

Pacific Southwest Airlines, a unit of PSA Inc., said IBM bought investment tax credits and tax depreciation associated with 10 DC9 Super 80 aircraft and related equipment. The planes, acquired by PSA, are valued at about \$200 million. PSA previously had announced the sale and indicated that the total gain would be about \$9 million; PSA had included a \$2.3 million gain from the sale in third quarter earnings.

#### ASARCO

Asarco Inc., a mining concern hurt by low metal prices, said it will receive about \$32 million in cash relating to about \$100 million in mining, smelting and refining equipment. The concern said it received about \$26 million in cash relating to about \$82 million in equipment under the first closing yesterday. The rest of the transaction will be completed in late December, Asarco said. The buyer wasn't disclosed.

#### WHEELING-PITTSBURGH STEEL

Wheeling-Pittsburgh Steel Corp. said it transferred tax benefits on certain equipment to Batus Inc. in return for a cash payment of \$25 million to \$35 million. The transaction relates to equipment valued at \$100 million to \$150 million.

Batus is a Louisville-based holding company with interests in tobacco, retail and paper companies.

#### PHELPS DODGE

Phelps Dodge Corp. said it has received \$18.7 million in cash from the sale of tax benefits to General Electric Co. The transaction, through General Electric credit Corp., is associated with \$66 million in equipment.

#### MILWAUKEE ROAD

The bankruptcy trustee of the Chicago, Milwaukee, St. Paul & Pacific Railroad, commonly called the Milwaukee Road, said he completed a sale-leaseback agreement that should be valued at \$15 million to the carrier over three years. The buyer wasn't identified.

#### CIT UNIT OF RCA OFFERS LEASE TAX-BREAK PACKAGE

NEW YORK.—C.I.T. Corp., a unit of RCA Corp., is offering smaller companies a chance to get in on the new sale-and-leaseback tax breaks of the new tax code.

If a company borrows money through C.I.T. to buy \$100,000 or more of new equipment eligible for tax breaks it doesn't need, C.I.T. will find that company a purchaser for those benefits.

The purchaser of the tax benefits will pay the real buyer 16.1 percent of the equipment's purchase price. The real buyer keeps the equipment.

In exchange, the tax-break purchaser can deduct depreciation on the equipment from its taxes, in addition to reaping any investment tax credits on equipment eligible for them.

C.I.T. said capital goods purchased must qualify for depreciation over five years under the August Economic Recovery Tax Act's accelerated cost recovery system.

That five-year category includes most industrial equipment and machinery, C.I.T. said.

The 16.1 percent payment is good for purchases made until Dec. 31, C.I.T. said. It hasn't announced the cash percentage for transactions after Jan. 1.

[From the Wall Street Journal, Nov. 16, 1981]

#### LEASING ACCORDS INVOLVE BILLIONS IN GEAR AS INITIAL ROUND OF TAX CREDIT SALES ENDS

Companies continued their rush to set up leasing arrangements under the new tax law before last Friday's deadline.

The transactions are the result of a provision of the Economic Recovery Tax Act of 1981 that allows companies to sell unusable depreciation deductions and investment tax credits to highly profitable companies seeking to reduce their own taxes.

The sellers, for the most part, either have had losses and don't owe any taxes at all, or have a surplus of deductions and credits because of large capital-spending programs.

The law makes it easier for companies to sell their equipment and then lease back the items. The purchasing company gets the tax advantages and the seller gets cash and use of the equipment.

The law applied retroactively to equipment bought between last Jan. 1 and Aug. 13 but only if leasing arrangements were made by last Friday.

The extent of the leasing activity isn't known. "I don't think anyone has any statistics yet and there probably won't be any for a while," said Tom Healey, managing director and head of the project finance group at Dean Witter Reynolds, Inc. Mr. Healey said estimates of the value of the equipment involved of \$10 billion to \$15 billion "seem right to my instinct."

Among companies disclosing last-minute agreements are:

##### DUN & BRADSTREET

Dun & Bradstreet Corp. said it paid about \$170 million for the tax benefits on equipment valued at about \$600 million. The company said it has entered into transactions with "several companies" but wouldn't identify them.

##### CHRYSLER

Chrysler Corp. said it sold investment tax credits and depreciation on almost \$150 million of machinery and tooling to General Electric Co. The auto maker said it received about \$26 million from the transaction.

Chrysler agreed to the basic arrangement with General Electric before the Treasury Department announced its preliminary rules for the lease arrangements. The transaction almost fell through because the rules didn't seem to offer sufficient protections to buyers of the tax benefits in the event of a bankruptcy by the seller.

The Treasury, under pressure from Chrysler and other financially troubled companies wanting to sell tax credits, agreed to modify the rules last Tuesday. That led to a mad scramble by Chrysler and GE to put their transaction back together by the Friday deadline.

R. S. Miller Jr., Chrysler's executive vice president of finance, said the company plans to consider bids on about \$40 million in equipment and tooling it will acquire in the fourth quarter. Sources said GE already has offered to buy the Chrysler credits.

##### ARIZONA PUBLIC SERVICE

Arizona Public Service Co. said it completed the previously reported sale of tax benefits to General Electric Co. The investment tax credits and accelerated depreciation involve \$250 million of equipment at the Cholla power plant. Arizona Public Service said the sale would result in a net benefit of \$50.6 million for the utility and enable it to avoid seeking financing this year in the domestic debt market.

##### GLOBAL MARINE

Global Marine Inc., an offshore-drilling contractor, said Hilton Hotels Corp. bought depreciation tax credits associated with four offshore-drilling rigs valued at \$135 million. Global Marine said the transaction doesn't include the sale of invest-

ment tax credits. The companies wouldn't say how much benefit each would receive from the transaction.

#### LONE STAR

Lone Star Industries Inc. said it sold tax benefits to a company it wouldn't identify for more than \$60 million in cash. The cement maker said it expects to complete another transfer by year-end that would net another "several million" dollars.

Long Star said the transaction primarily was related to tax benefits from the expansion and modernization of its Santa Cruz, Calif., cement plant and similar projects at other plants. The company won't disclose the value of the capital expenditures involved, or the effect on earnings.

#### REPUBLIC AIR

Republic Airlines said it transferred tax benefits on "certain aircraft and spare engines" that had been placed in service in 1981. Republic didn't disclose the value of the property, but said the transaction produced about \$19 million, which the airline used to reduce floating-rate bank debt.

#### MITCHELL ENERGY

Mitchell Energy & Development Corp. said it sold \$18.5 million of investment and accelerated depreciation tax credits. Mitchell wouldn't identify the buyer. Mitchell, an oil and natural gas company and real-estate developer, said the credits were available for sale because of a surplus of tax credits generated from its energy capital program. Cash from the sale will be used to reduce company debt, Mitchell said.

#### ALASKA AIR

Alaska Airlines said it sold a Boeing 727 for \$14 million to a buyer it wouldn't identify and leased it back for 11 years with a new purchase option at the end of that lease. Under this transaction, Alaska Airlines keeps the investment tax credit and the buyer gets accelerated depreciation.

#### CHICAGO & NORTH WESTERN

Chicago & North Western Transportation Co. said it completed a sale-leaseback trade action involving sale of tax benefits on property, including locomotives and freight cars valued at about \$53 million. The cash value of the transaction to Chicago & North Western is about \$13 million, the railroad said it wouldn't identify the buyer.

#### MARSH & M'LENNAN

Marsh & McLennan Co. said it bought tax benefits related to \$35 million capital equipment owned by Boston Edison Co. Boston Edison said it received \$6 million cash as part of the transaction. Neither company would estimate the effect of the transaction on earnings.

Marsh & McLennan, an insurance broker, also purchase tax benefits last week from Occidental Petroleum Corp. related to about \$95 million of capital equipment. It reported, Marsh & McLennan told analysts that the company's per-share earnings would be increased by three to five cents in 1981 because of the Occidental transaction and by about 50 cents over the 15-year total of the lease.

[From the Wall Street Journal, Nov. 17, 1981]

#### N&W BUYS \$40 MILLION IN TAX BENEFITS, MOVING AGAINST TREND OF RAIL INDUSTRY

In contrast to several other railroads that recently arranged to sell tax benefits, Norfolk & Western Railway said it bought tax benefits for more than \$40 million. The benefits apply to more than \$200 million of equipment from two companies that aren't engaged in railroading, N&W said yesterday.

N&W, a profitable railroad based in Roanoke, Va., declined to identify the two companies involved in the transactions, which were arranged under a provision of the Economic Recovery Act of 1981. An N&W spokesman responded with "no comment" when asked if one of the concerns was Flexi-Van Corp., a New York-based lessor of vansized containers and trailers.



On Friday, Flexi-Van had announced the sale of \$120 million of tax credits and tax deductions of equipment.

#### NATIONAL STEEL

National Steel Corp. said it sold tax credits on various assets valued at about \$60 million. National Steel disclosed neither the price nor the buyer. However, EG&G Inc., a high-technology company based in Wellesley, Mass., said it bought \$20 million in tax benefits from National Steel on equipment for processing steel and aluminum.

#### SCOTT PAPER

Scott Paper Co. said it received about \$42 million in cash from the sale of tax benefits on equipment. The buyer wasn't disclosed. The company said proceeds will be used for plant modernization and expansion.

#### CLEVELAND ELECTRIC

Cleveland Electric Illuminating Co. said it received \$23.2 million for tax credits and depreciation deductions on about \$116 million of electric utility equipment. The benefits were bought by a unit of Standard Oil Co. (Indiana). Cleveland Electric said the transaction with Amoco Tax Leasing Corp. will improve its cash position by reducing its current need to borrow money at high interest rates and by deferring the need to raise long-term capital.

#### THERMO ELECTRON

Thermo Electron Corp. said it paid \$13.8 million for tax benefits on equipment valued at \$65 million. The Waltham, Mass., maker of process equipment and environmental monitoring instruments wouldn't identify the seller.

#### CONTINENTAL AIRLINES

Continental Airlines said it received \$24 million on the sale of tax benefits on \$94 million in assets to Metromedia Inc.

Los Angeles-based Continental said the benefits consist mainly of investment tax credits that it couldn't have used for several years because of recent losses.

#### UNITED CABLE

United Cable Television Corp., Englewood, Colo. said it sold tax benefits from \$30 million of installed cable television networks to Consolidated Freightways Inc. for \$5.8 million.

#### WATSCO

Watsco Inc., a Hialeah, Fla.-based maker of cooling, heating and solar-energy parts, said it paid a unit of Pantry Pride Inc. \$750,000 for tax benefits on assets valued at about \$6 million.

#### GREAT AMERICAN

Great American Industries Inc. said it bought tax benefits on \$25 million of equipment from Oxford Resources Corp., a unit of Trexar Corp. Great American, based in Binghamton, N.Y., didn't disclose the price.

#### PAN AM

Pan American World Airways said it sold for \$47 million tax benefits on four Lockheed aircraft. Pan Am wouldn't identify the buyer.

The airline said the terms of the agreement called for the buyer to pay \$15.6 million in cash. The \$31.4 million balance will be invested by the buyer according to Pan Am's directions and paid over 18 years with the interest earned, a spokeswoman said.



[From the Wall Street Journal, Nov. 18, 1981]

#### METROMEDIA PURCHASES CREDITS, DEDUCTIONS ON \$350 MILLION IN GEAR

Metromedia Inc. said it paid about \$80 million for investment tax credits and depreciation deductions on about \$350 million in equipment.

The company didn't identify the sellers but said they include several public and closely held concerns.

The purchase was made under the liberalized leasing provisions of the 1981 tax law that allow companies to sell unusable tax breaks to profitable concerns seeking to reduce their federal taxes. The broadcasting company previously reported a transaction with New York's Metromedia Transportation Authority, in which Metromedia bought buses and railroad cars to gain a \$102 million tax break over the next five years. Metromedia agreed to pay \$15.5 million and the MTA retained use of the equipment by leasing it back from Metromedia.

Metromedia's announcement follows a flurry of agreements reached before a deadline last Friday for taking advantage of a retroactive provision in the new law. The provision allowed companies to arrange sale-leaseback agreements on equipment purchase between Jan. 1 and Aug. 13, when the law took effect.

Among the companies announcing agreements yesterday were:

#### LTV

LTV Corp., Dallas, said its Jones & Laughlin Steel Inc. unit sold for about \$33 million tax benefits of \$100 million relating to steelmaking equipment. The buyer wasn't identified.

#### MOORE M'CORMACK

Moore McCormack Resources Inc., a Stamford, Conn., steamship operating and mine managing concern, sold its investment tax credits on a ship to an oil company for \$19 million. Moore McCormack didn't disclose the buyer.

#### FOOTE, CONE & BELDING

Foote, Cone & Belding Communications Inc. said it bought about \$10 million in tax benefits from three companies. The Chicago-based international communications and advertising concern wouldn't identify the sellers.

#### WORLDWIDE ENERGY

Worldwide Energy Corp. said it sold for about \$700,000 tax benefits on \$3 million of equipment under a sale-leaseback agreement. The Denver-based concern said that under proposed financial accounting standards, the sale will contribute about \$300,000 to fourth quarter earnings. The buyer wasn't disclosed.

[From the Wall Street Journal, Nov. 19, 1981]

#### AMAX

Amax Inc. said it will receive about \$23.5 million in cash from the sale of tax benefits related to about \$85 million of equipment. The Greenwich, Conn., natural resources concern said it already has received \$19.8 million cash under the first closing last Thursday, and the rest of the transaction will be completed next month.

Amax, which didn't identify the buyer, said it will use the proceeds to reduce borrowings and related interest costs.

#### DYNALECTRON

Dynalelectron Corp. said it bought about \$670,000 in tax credits, related to about \$3.5 million in equipment, from three companies. The McLean, Va.-based technological services concern, said that the transactions were completed last Friday and that it will lease back the equipment over 10 years. The sellers weren't identified.

#### OHIO EDISON

Ohio Edison Co. said it sold tax benefits for about \$36 million. The Akron-based utility said the first part of the transaction, for \$29 million, was completed last week, and the second part is expected to be completed in December.

Mr. DERRICK. Mr. Bonior.

Mr. BONIOR. Thank you, Mr. Chairman.

Professor McDaniel, thank you for coming and for a very, very fine comprehensive statement. I am very impressed with your analysis of the so-called safe harbor leasing provision. I am prefacing all my tax statements with "so-called" these days. It is just incredible, to use an overworn word, that we could be paying transfer payments, \$10 billion to \$12 billion, to brokers to put together deals.

Mr. McDANIEL. It is not just brokers. It is the profitable corporations.

Mr. BONIOR. And the profitable corporations. I think you illustrate that well in your testimony. Could you talk to us a little bit about the Canadian example that you allude to in your testimony?

Mr. McDANIEL. Yes; they have a so-called envelope system, which was instituted in 1979 when they published their first tax expenditure budget. Each of what corresponds to our executive branch departments is given a budget target to reach for spending in its area of responsibility. It is assigned not only the direct programs but the tax expenditure programs that are in that same area.

For example, in the U.S. context, suppose that the decision were made to spend \$2 billion on educational programs in a given year. If the aggregate of the tax expenditure programs for education and direct programs for education were \$2.4 billion, the Department of Education would be required to come forward with modifications which would reach the \$2 billion level. It could do that by cutting direct spending, by cutting tax spending, or some combination of the two, or perhaps simply by restructuring one or the other forms of programs to make it more efficient and eliminate some waste.

Mr. BONIOR. The department does?

Mr. McDANIEL. That is right.

Mr. BONIOR. I don't thoroughly understand the parliamentary system there.

Mr. McDANIEL. Under that system, of course, the executive branch has much tighter control over the budget as it goes forward to Parliament than the executive branch here does as the budget comes to Congress.

Mr. BONIOR. An extension; yes.

Mr. McDANIEL. As far as I know, I don't see why the executive branch couldn't institute that system today if it wished.

Mr. BONIOR. On their own?

Mr. McDANIEL. On their own.

Mr. BONIOR. I think that is what Mr. Eizenstat was suggesting.

Mr. McDANIEL. Right.

It seems to me entirely appropriate. In Congress, of course, we would have to come up with an institutional procedure taking into account committee jurisdictions. I think it could be done under the Budget Act process, but it would be a dramatic change from present procedures. I think it could be done, for example, by giving each budget function an overall limit, and the limit would have to be reached taking into account both tax and direct spending.

In a way, this was done—although I don't know if it was recognized—in the Energy Act in the House in 1978, when you created

the Ad Hoc Energy Committee, on which were representatives of all the committees.

Mr. BONIOR. The tax-writing committees.

Mr. McDANIEL. Including the tax-writing committees. There was a combination of tax credits for energy as well as some direct payment programs for low-income people and the like. And really, although I don't know, if it was contemplated or understood, basically it was this process I have suggested that was taking place. Total energy spending could not exceed a certain amount and the ad hoc committee made sure it reached that figure by direct and tax expenditures.

Mr. BONIOR. As you have indicated, there are some real political and turf problems involved with moving in that direction, but I think, as I stated to Mr. Eizenstat, at some point perhaps down the road that is a logical extension of the movement toward dealing with this whole issue.

There are those who claim that the definition of tax expenditures is so arbitrary or vague as to have no meaning economically or legally. Would you comment on that criticism?

Mr. McDANIEL. I don't think it has much basis in fact or history. We have had, since the Budget Act of 1974, and really since the early 1970's, three different staffs who have been responsible for developing tax expenditure budgets: The Joint Committee staff, the CBO staff, and the OMB staff. Those budgets for many years have been identical. When one presses, asks someone for an example of a questionable item, you get one, two, or three items. But there are 104 items on the list, and the vast majority of those items I think no one would quarrel with.

I had an interesting recent experience. There is a great deal of interest in the tax expenditure concept in other countries. Most other countries are now adopting tax expenditure budgets. I am working with a group of fiscal experts from seven OECD countries who undertook the task of comparison of expenditure budgets for all countries. This meant that they had to agree on the definitions of each of these hundreds and hundreds of items.

That group met in Rotterdam last June and in fact agreed on a uniform set of guidelines by which to identify tax expenditures, although they weren't even coming from a common tax system as we are, in the United States. Instead these experts were from seven different histories and tax traditions and yet they were able to reach agreement on a uniform set of guidelines by which one could identify tax expenditures. So I think that tax and budget experts, given the task, can achieve the objective of identifying tax expenditures and do so in a way in which there is a high degree of agreement that they are, in fact, correct.

Mr. BONIOR. That is very interesting. We would be more than interested in getting some written response on that exercise.

Mr. McDANIEL. I would be happy to forward it to you.

Mr. BONIOR. What did the final product in terms of definition look like as compared to what we have in the budget?

Mr. McDANIEL. Very close to the same results. There are two or three modifications of our own system that the group prefer to use. For example, in the area of housing they prefer to show the failure to tax net imputed annual rental value as a tax expenditure,



whereas in the United States we list the deductions for interest and property taxes. But, generally, differences involved matters of a technical nature like that. Two or three items will appear on that list that aren't in ours, and vice versa, but more as a matter of technical definition rather than philosophy or definitional difficulties.

Mr. BONIOR. I thank you again, as the leading authority on this issue, for coming and helping us with this very difficult problem.

Mr. McDANIEL. My pleasure.

Mr. BEILENSEN. Professor, your testimony today was just as excellent and helpful as your testimony on a similar subject the last time you were down here. I remember your testimony at that time.

Mr. McDANIEL. Since that time I think the tax expenditures have grown by about \$86 billion. Our discussion, I guess, was interesting, but it hasn't done the job yet.

Mr. BONIOR. Will the gentleman yield?

Mr. BEILENSEN. Surely.

Mr. BONIOR. It hasn't done the job but I think you are seeing a lot more interest in the issue because of its growth. As I noted yesterday, and I am sure you noted through the media, there are Members of the other body now who are serious about looking at the issue, because of the impending large deficits that the country faces. So I think we are getting quickly to the point of doing something about the issue.

Mr. BEILENSEN. I think we have a lot more leverage on the subject now since such painful cuts are being offered—in fact, made—in some direct expenditure programs. The cuts are forcing everybody to take a hard look at some of these things which just a few people like yourself and a few others were paying attention to in the past.

Thinking out loud on the discussion between yourself and Mr. Bonior with respect to turf and jurisdictional problems, they might not be quite so great as you were alluding. Obviously, a tax-writing committee would be offended if discussions of these things were referred to a policy committee jointly with them.

However, I would think that the policy and authorizing committees would be delighted to have a chance to look at these things and to have the opportunity to contribute their own expertise to the resolution of these problems in the best possible way. I should think there would be a lot of support for that kind of referral because of that.

Mr. McDANIEL. I think you are right. The problem shouldn't be overstated. In the hearings before the Budget Committee 2 weeks ago, for example, Senator Moynihan, who is a member both of the Finance Committee and the Budget Committee, expressed his support for the proposition that that joint referral procedure in fact could work, and expressed his view that it was a desirable step.

Mr. BEILENSEN. Overall, there would be more Members of each House involved in the authorizing committees than there are members of the tax-writing committees and, therefore, for the first time they, too, would have a chance to look at these things.

Mr. Derrick.

Mr. DERRICK. Thank you very much for your testimony. I think it is going to be necessary over the next few years for us to make sev-

eral adjustments in the way we spend and collect money. One is the tax expenditure, and I also think we will have to include off-budget items to give us an overall picture, a realistic picture of where we are going.

I was interested in your comments about some form of accounting, accounting in the sense that the taxpayers made a count on this. Do you mind elaborating on that just a little bit further? What do we do other than to double the staff of the IRS? What are our alternatives?

Mr. McDANIEL. It is difficult, if one is going to use an entitlement program approach, to see how you can have an effective check, without an increase in the IRS audit staff. As Mr. Eizenstat stated, at a time when you are only auditing 2½ percent of individual tax returns—

Mr. COHEN. 1.85.

Mr. McDANIEL [continuing]. It is obvious that we are checking these tax entitlement programs, auditing them, at a far lesser rate than we audit some of the direct welfare programs or other kinds of entitlement programs.

One way to bring that problem under greater control might be to start imposing dollar limits on individual tax spending programs. In this respect I disagree with Mr. Eizenstat. I think you can put direct dollar limits on individual tax expenditure programs.

The Carter administration, for example, at one time was considering, maybe did propose a system of tax expenditures and direct expenditures for inner-city redevelopment. That proposal includes a limit of \$2 billion on the tax expenditure program, and thus there couldn't be tax credits claimed in excess of \$2 billion.

That limit was going to be enforced, as I understood it, by having businesses that thought they qualified filing reports to that effect with the Commerce Department. Once \$2 billion was reached, that was it for the year. It was a sort of first through the gate approach. But I guess we follow that approach in some direct entitlement programs too, when Congress decides enough spending has taken place for the year. Obviously, more refined techniques could be developed.

But short of shifting away from entitlement programs into a system whereby the departments would take an advance look at particular tax spending programs before awarding the tax benefits, it is difficult to control tax spending without increased IRS audit staff.

That is a technique we sometimes use in the tax system. For example, special tax benefits are provided for certified historic structure rehabilitation, but the taxpayers must first obtain a certification from the Department of the Interior. Sometimes therefore, we do require some action before a tax benefit can be claimed. In addition perhaps bringing in other departments to assist the IRS in the audit process might be one possible solution without having to increase overall Government employees as such.

Mr. DERRICK. That is all.

Mr. BEILENSEN. Professor, we thank you very, very much for coming and sharing your experience with us.

Mr. BEILENSEN. The next witness is the Honorable Sheldon Cohen, former Commissioner of the Internal Revenue Service.



**STATEMENT OF SHELDON COHEN, FORMER COMMISSIONER OF  
THE INTERNAL REVENUE SERVICE**

Mr. COHEN. I have prepared a short outline, which I will try to elaborate on.

I am a partner in the Washington law firm of Cohen & Uretz, but I speak today neither for my partners nor any of our clients. These are my own personal views.

I had the privilege of being Commissioner of Internal Revenue in the first year the United States collected \$100 billion. It is rather appalling to me today to look at the fact that this may be the first year in which we have a \$100 billion deficit.

Mr. DERRICK. What year was that?

Mr. COHEN. I was appointed December 1964. I took office in January 1965. The first full year began the next July, and that was the year in which we collected \$100 billion, 16 years ago.

I generally support the legislation that you are studying. However, I didn't come today to discuss the ideologies of tax expenditures, nor do I want to take on those who say that there is no such thing as a tax expenditure, since the Government has no right to an individual's property.

As Professor McDaniel has stated, I think that tax authorities and fiscal authorities worldwide would agree that there is such a thing as a tax expenditure because the Congress, by conscious act, makes decisions that way.

In either case, it is absolutely essential that we have respect for our tax laws. To have that respect requires that the laws be fairly, uniformly, and equitably administered. The burden of that responsibility falls on the Internal Revenue Service, and by and large it has fulfilled that role rather well.

That is a blessing and a curse. It is a blessing because a fair and strong tax system is necessary to a democratic society. It is absolutely essential. You cannot exist without it. It is a curse that because of this very efficiency more and more jobs are thrown at the IRS, without thought of the consequences or without providing adequate resources.

One would not provide a funding program in the Commerce Department without providing the personnel to supervise it. If a check is to be written, the Congress would insist that there be an adequate procedure to verify factual background, the claims being made, and the adequacy of the data on which the check was issued.

The IRS is, in effect, issuing checks every day. We don't provide the adequate data now, then adequate means of verifying them later.

Tax administration, like almost everything in life, is subject to the law of diminishing returns. The more elaborate the tax system, and the more objectives that you attempt to use the tax laws to accomplish, the more administrative responsibilities you throw on the Internal Revenue Service, the less efficient that system is going to be.

My litany is much like the litany given you a little while ago; that is, it doesn't take much imagination to see it is the job of the Labor Department to provide job subsidies and pension qualifica-

tions. Job subsidy and pension qualifications are provided by the Internal Revenue Code.

It is the job of the Energy Department to provide energy credits, depletion deductions, and various other encouragements to nonconsumption or to production of various forms of energy. You have put those responsibilities on the Internal Revenue Service. The whole of the energy program is dependent not on the Energy Department but on the IRS.

The Agriculture Department should provide farm subsidies. Part of those farm subsidies are provided in the Internal Revenue Code. The Secretary of Agriculture really doesn't have any voice in this.

In the Commerce Department they ought to be administering a law called DISC. It has nothing to do with the revenue system. There are various encouragements to foreign operations also in the tax system.

Industrial development bonds are used to develop inner cities, to build stores, to do various things that have nothing to do with the revenue system. They have to do with local development. Many of them don't even have to do with the Federal Government, interestingly enough. They are all local, but they are built into our tax system.

We have made a grant program out of the Internal Revenue Code. The cities and States line up at the door and you can provide a subsidy to someone to build a plant.

We have housing subsidies. They ought to be administered by HUD, but the bulk of your housing subsidies are handled by the Internal Revenue Service.

The whole education system is dependent on the tax exemption. Where does the expertise in the Internal Revenue Service come from to determine what is educational, what is scientific?

In the transportation system you have airport subsidies, you have road subsidies, you have a whole variety of subsidies in the transportation system. I will bet you that there is more money expended in the Internal Revenue Service than provided in the Transportation Department.

In the Justice Department—you think law enforcement activities are centered in the Justice Department? I am testifying at a hearing next Monday on whether we ought to expand the criminal law enforcement activities within the Internal Revenue Service. No increase in personnel will be provided.

That is only the beginning. If I had labored over this list for a couple of weeks, that list would be pages long.

It is not as silly as it sounds but, if we were to continue the proliferation of these tax incentives, or disincentives, we could abolish all the other departments of Government and the Internal Revenue Service would control the whole operation.

I suggest to you that you all would agree with me that that is not sound policy. We have been moving in that direction. No one has sat down thoughtfully and said this is what is happening, but it is, it really is.

I saw it in the 5 years I was at the Internal Revenue Service from late 1963 to early 1969, and I have watched it ever since.

Interestingly, I first came to the tax law in 1952. I was legislative draftsman for the Treasury Department. In preparing for what was

the Internal Revenue Code of 1954, we spent a full year, from January 1953 to December 1953, studying what were the alternatives and how could they be accomplished.

It was a joint effort. There were congressional staff people. There were economists from the Treasury. There were people from the IRS. There were lawyers from the Treasury Department, all of whom participated in that study. Only after a full year's study was a bill, H.R. 5400, introduced in January-February 1954. It became law, August 16, 1954.

The law stood pretty well. It had relatively few defects. One of them was a provision that was repealed retroactively within a few months. In contrast the 1981 law was introduced late in the spring and was passed on August 13. No long study nor preparation.

I venture to say we will have a different experience with that law, and that has been experience, by the way, for the last 10 years. We propose a law and it will be passed within 3 or 6 months.

There is no digesting period where industry can comment that you didn't think about this or, if you work it through, the statute won't work properly. There was none of that in the 1981 act because the Senate had the hearings first and the House had the hearings second. There wasn't even an opportunity to pass a bill in one House and have a second look at it so the technicians could rework the technical aspects of that bill.

Then you had a report that was written overnight, the conference having worked all through the evening, one day until 1 a.m., 2 a.m., or 3 a.m. the next morning. We can't draft legislation that way. It just won't work. I mean, none of us are that smart.

What I am concerned about here is that we have taken a fine administrative agency, probably the best in the Government, and we are pushing it toward inferior performance. We expect too much.

There are elementary principles of management. Those of you who have studied them say there is a span of control. One human being can supervise  $x$  number of functions or  $x$  number of people, and you can't keep proliferating the work load.

We can't expect a revenue agent, because that is the person on the firing line, to be a social worker, a teacher, a housing expert, an oil and gas engineer, a policeman, you name it, or all of the other things that we expect him to be.

Mr. Eizenstat and Mr. McDaniel commented on that. I can reiterate it because I have talked to them. I have seen their frustrations.

Each time there is a new Congress or each time there is a new administration—and I do cast rocks at both Democrats and Republicans in this respect—there is a cry for simplification of our tax laws. We all want that, and it is an important goal, but it can't be reached until the Congress has the discipline not to attempt to cure every economic and social ill with a tax provision.

That is our current trend because it is easier than appropriating money. It seems easier not to collect the revenue than to say I took the money in and I gave it to an individual or industry, because there is some criticism of to whom you may give it.

That is the reason that you have that "rent a deduction" provision, as I like to call it, which Professor McDaniel discussed. This

will be a boon to tax lawyers, and it is a boon to brokerage houses, and it is a boon to buyers. It was designed to give poorer corporations equality with prosperous ones, but as you find out they get equality—but it is like the animal farm. Some of them are more equal than others because there is a discount attached to their benefit. If I am going to buy a deduction from you and I have a superior economic position, I am going to exercise that superior economic position. I am going to take a chunk of profit on it. That is the economic system, but you in Congress allowed it.

I think we have got to stop quick fixes. They make bad law. They make bad law in the tax law or bad law anywhere else. We are inadvertently going to destroy the very administrative system that we keep expecting to pull our coals out of the fire.

I think that it is good to examine this whole area of tax expenditures because that is where the action is at this time. To quote some of my friends in the current administration, there is no free lunch. For everything in life there is an economic cost. You can hide it, but you can't get away from it. We are rationalizing too much these days in this particular area.

Thank you.

[Mr. Cohen's prepared statement follows:]



Testimony of  
Sheldon S. Cohen  
before the  
Committee on Rules  
U. S. House of Representatives  
December 10, 1981

Re: Tax Expenditures

My concern today is not with the ideology of tax expenditure -- or with those who contend that since the government has no right to an individual's property, there is no such thing as a tax expenditure.

In either case, respect for our tax laws requires that they be administered fairly and equitably. The burden of this responsibility falls on the Internal Revenue Service, and by and large it fulfills its role well. That is both a blessing and a curse: a blessing because a strong and fair tax system, effectively administered, is necessary to a democratic society; a curse, that because of this very efficiency more and more jobs are asked of it.

Tax administration, like most other things, is subject to the law of diminishing returns. The more elaborate the tax system -- and the more objectives attempted by the use of the tax law and the more the administrative responsibilities we expect of the IRS, the less efficient our system will be.

It does not take much imagination to see the IRS saddled with most of the jobs of the:

- Labor Department (job subsidies, pension qualification);
- Energy Department (energy credits, depletion deduction, other encouragements to exploration);
- Agriculture Department (farm subsidies);
- Commerce Department (DISC, foreign subs & sales, IDB's);
- HUD (housing subsidies);
- Education (tax exemptions for education);
- Transportation (airport subsidies);
- Justice (law enforcement activities);

etc., etc.



This picture is not as silly as it may sound. If we were to continue the present proliferation of tax incentives or disincentives much longer, we could abolish the other departments of government and let the IRS do it all. I suggest to you and believe that most members of Congress would agree that this is not sound policy.

My concern is that we have taken a fine administrative agency and are pushing it toward inferior performance. We expect too much. A revenue agent is not a social worker, teacher, housing expert, oil and gas engineer, policeman, or all of the other things we are calling on him to be.

The Congress and each new administration preaches that we should simplify our tax laws. This is an important goal, but it can never be achieved so long as you, the Congress, insist on attempting to cure every economic and social disease with a tax provision. The quick fix will create bad law -- and inadvertently will destroy a good administrative system.

We must reexamine this drift before it is too late. I believe we still have time, but this Committee and the leaders of Congress must act to stop the use of our tax laws for such a multiplicity of purposes.

Mr. BEILENSEN. Mr. Frost?

Mr. FROST. I enjoyed the gentleman's testimony, but I do have to ask the specific question about how he feels about the legislation before us. I understand your position on what we have done as a general proposition with the tax code. I am not quarreling with you about that, but do you feel that this particular piece of legislation is useful?

Mr. COHEN. It is. It is useful in that it would require more scrutiny, more examination, and therefore I suspect would lead to less use of tax expenditures. I don't think they would proliferate as much, and there may even be some contraction when one really looks critically to see some of the conflicts between various items.

Mr. FROST. To extend that further, if I do understand, it would be your preference that we eliminate some of the provisions in the current Tax Code, that we back away from some of the areas that we have taken the tax law into.

Mr. COHEN. Well, this is not the place to discuss my views on tax policy, but we can't have it both ways. We can't have administrable law that keeps piling on provision on provision like a "Tower of Babel," where we may or may not be able to reconcile the provisions.

We as tax lawyers make our living that way, so I am speaking against my own interest in that respect. The more complex you make it, the more people need people like me or some of my brethren at the bar, but even we have frustrations. I mean, we would rather be doing something productive than to analyze provisions that just don't make a whole lot of sense.

Mr. BEILENSEN. Mr. Bonior?

Mr. BONIOR. Thank you for coming and testifying and being supportive of the legislation.

Did the IRS, when you were there, compile statistics of usage and studies of tax expenditure effectiveness? I know we are just starting to.

Mr. COHEN. The concept of tax expenditures was being developed when I was there. Professor McDaniel, who was on the staff at that time, Assistant Secretary Surrey and I participated in a variety of meetings. Yes, the data was being developed then from the statistics of income which are produced from the IRS tax returns.

There is very valuable economic data that are produced and published, and because of the confidentiality of tax returns, the data are published with no identification of taxpayers. But there are data that are available for analysis that will produce reasonable estimates of the utilization of our tax law provisions. From the data in the past one can, by various statistical methods, project into the future the probable utilization of these various provisions.

Mr. BONIOR. There are studies today that look at usage and effectiveness of these expenditures?

Mr. COHEN. Oh, yes, and it is becoming more and more. The statisticians and the economists are becoming more and more sophisticated in the analysis of these provisions.

Mr. BONIOR. I am speaking, though, of a body within IRS that does this.

Mr. COHEN. The body within IRS is purely a statistical body which is required by law and practice from time to time to publish

statistics of income in various classifications. This data is available for analysis by others. Those others include the tax economists on the Treasury staff, the economists at Brookings and AEI, and all the various other analytical groups who could not operate without that kind of data.

They also produce tax models from which one could test, and the Congress does use for the purpose of testing the revenue loss or gain from various provisions; that is, if you are going to decrease the depletion allowance by  $x$  or increase it by  $x$ , what will be the revenue effect. Those models are readily available.

Mr. BONIOR. Who checks on the effectiveness of the IRS? GAO?

Mr. COHEN. The IRS has a variety of means for that purpose. There have been studies, of course.

Mr. BONIOR. Within the Government?

Mr. COHEN. The IRS has had, I think, probably one of the oldest Inspector General operations in the Government, created in the early fifties when I first came to the Service. It is notably successful and effective.

The IRS is answerable to the Joint Committee on Taxation, which has an oversight function, and reviews on occasion some of its functions and indeed is charged by law.

There is an interesting provision in the Internal Revenue Code that requires the Joint Committee on Taxation, to review every refund in tax made to anyone of \$200,000 or more.

Now, that number has changed over the years. It was \$75,000, it was \$100,000 and now it is \$200,000. That is curious. A revenue agent all by himself could pass on a deficiency of \$1 million, \$5 million, \$50 million with little review, but you require him, if a check is going to be written for \$200,000, to report it to your committee and wait a given period before that check can be sent out.

It is a rather curious provision and rather wasteful. The GAO likewise has review of certain functions within the Treasury Department, and within the IRS.

I think the Service is thought of as probably the best or amongst the best run operations of Government. There was an independent review—the administrative conference ran a study a few years ago of a number of these areas and gave the Service a very favorable report, although it criticized them in a number of respects.

The National Academy of Public Administration has at various times reviewed a given area and come up with good reports. I mean in terms of mild criticism, and favorable reports on most of the activities. But of course the IRS is not without blemish.

Mr. BONIOR. Oh, yes. You know, we hear a lot and we have heard a lot within the last few years in the Congress about the trilogy of waste, fraud, and abuse, as it applies primarily to direct expenditures. Outside of the safe harbor leasing provision that we just talked about, you just don't hear that much about it with respect to tax expenditures.

Mr. COHEN. The Revenue Service has about \$16 billion worth of uncollected accounts. Now the scandal is not that the Service isn't working on it, but they don't have sufficient personnel to do the necessary job.

Mr. BONIOR. \$16 billion?

Mr. COHEN. Yes; most of which is collectible if you had the personnel.

Mr. BONIOR. It is collectible.

Mr. COHEN. This administration and the last administration refused to increase the budget. The audit level has fallen probably by at least 50 percent. The audit level when I was Commissioner was close to 40 percent. Our goal then was about 5 percent. Last year I think the audit level was about 1.8 or 1.9 percent.

Mr. BONIOR. How much, as a guesstimation, would it cost in additional personnel to recoup the \$17 billion, did you say?

Mr. COHEN. \$16 billion. That was my last figure. That was the last number I saw. I don't know. I am close enough to the Service and know enough of their problems to know that they have been hurting both in terms of collection personnel and audit personnel over the last few years.

The present administration has basically had a stand-fast budget. I think they might have 100 or 200 personnel for the whole year more. If you look at the job of the Service, the job increases about 2 to 2.5 percent a year. It increases with the number and complexity of returns, and the U.S. population increases at about 2 percent a year.

So, if you stand still, in other words, if you keep the same number of personnel as you had last year, you have decreased their personnel by 2 percent in terms of the job to be done.

Mr. BONIOR. Is there a morale problem over there?

Mr. COHEN. You haven't much morale.

Mr. BONIOR. You haven't got any?

Mr. COHEN. No. What has happened, of course, is what has happened in other agencies; that is, that your best people who were in the stream of management, when they get their 30 years and reach 55 they leave.

When I was in the Government we probably had 10 or 15 percent who retired when they were first eligible. The last time I saw the data it is up to around 60 to 70 percent or more retire the day they first become eligible.

That is the pinnacle of a person's abilities in terms of those supervisory kinds of jobs. What it does is that tells the young person coming into the Service where he gets a good education and where he does good work and where he is paid reasonably well at the lower level, I am going to get my experience and I am going to leave. I am not going to make this a career because I am going to be capped out too quickly. If those people are leaving too fast, why should I stay?

For example, one of the key ingredients of running a good operation, whether it be private industry or government is a mobile managerial group. You can't run an organization, whether it be a large oil company or Sears Roebuck, or anything else without a mobile managerial group.

Now, why in the world would a grade 15, 16, or 17 person in the Government, all of whom make the same pay, move from a small town in the Midwest or in the Southwest to New York or to Washington, D.C., or Chicago or any of the higher cost areas?

You can't pay him much in moving expenses, you can't pay him for the differences in his housing cost, and he is going to make ex-

actly the same salary. He made \$50,000 when he was a grade 15 and now he is a 17 and has the whole State to worry about and he didn't get a single dollar in raise. Not only that, if he moved, he lost money.

That wasn't so when I was in the Government. We could pay moving expenses. A person would get an increase. It wasn't a huge increase, but he got an increase and he got prestige. You have now put him in the position of a bank teller. We won't give you a raise, but we will make you a vice president or we will make you a cashier. All you have done is give him an honor, responsibility, no money. That should not be the way the system works.

Mr. BONIOR. No; not at the end of the month.

Mr. BEILENSEN. Thank you very much for your testimony.

Mr. BONIOR. I ask unanimous consent that the record be held open to receive statements from the following parties: Chairman Rostenkowski, Congressman Conable, the National Association of Independent Colleges and Universities, and Senator Peter Domenici.

Mr. BEILENSEN. Without objection, it is so ordered.

[The statements referred to follows:]



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COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C. 20515

TELEPHONE (202) 225-4825

December 9, 1981

RECEIVED

DEC 9 1981

HOUSE RULES COMMITTEE

The Honorable Richard Bolling  
Chairman  
Committee on Rules  
U. S. House of Representatives  
H313, The Capitol  
Washington, D. C. 20515

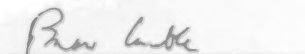
Dear Mr. Chairman:

This is in response to your letter requesting testimony on behalf of the Committee on Ways and Means before the Committee on Rules regarding H.R. 4882, to amend the Congressional Budget Act of 1974 to require that each congressional budget resolution fix the level of tax expenditures for the fiscal year involved as well as the recommended aggregate level of federal revenues.

We regret that due to the heavy legislative agenda of the Ways and Means Committee during these waning days of the first session, we will be unable to appear in person to comment on this legislation. We are, however, enclosing a joint statement on behalf of the Committee on Ways and Means and respectfully request that it be included in the printed transcript of your Committee's hearings on H.R. 4882.

Sincerely yours,

  
Dan Rostenkowski, Chairman

  
Barber B. Conable, Jr.  
Ranking Minority Member

Enclosure

STATEMENT OF WAYS AND MEANS COMMITTEE CHAIRMAN DAN ROSTENKOWSKI AND  
RANKING MINORITY MEMBER BARBER B. CONABLE, JR., ON H.R. 4882  
SUBMITTED TO THE COMMITTEE ON RULES

DECEMBER 9, 1981

Mr. Chairman: We want to thank you for this opportunity to express our views on the proposed amendments to the Congressional Budget Act contained in H.R. 4882, introduced by our colleague from Michigan, Mr. Bonior. While our statement will focus on the serious reservations that we have to this specific legislation, we would like to make a few more general observations at the outset. Since the enactment of the Congressional Budget and Impoundment Control Act of 1974, many issues have arisen regarding the actual operation of that statute. We all know that there are many technical flaws in that statute and many "accommodations" have had to be developed in order for the process to function. In some cases, there is strong evidence, based on five years' experience, that the congressional budget process exceeds the authority of its enabling statute. While we have supported the budget process since its inception, we must necessarily express our concern about proposals such as H.R. 4882 which seek to expand the requirements of the budget process even before we address the serious flaws that exist in the present statute.

In addition, Mr. Chairman, when we look at the experience of the current congressional session in which the budget process is not functioning as any of us intended, we must call into question--not just from a technical standpoint, but from a policy standpoint as well--legislative changes which would put new demands on the congressional budget cycle. At the present time, we are several months behind in the passage of a second budget resolution. It is our understanding that for a combination of reasons when this resolution is passed, it will have very little substantive meaning. We believe that the Committee on Rules is properly exercising its responsibility to review the Budget Act, but its priorities should be directed to correcting technical flaws in the existing statute and more substantive flaws that have led the process to the point where it is today.

We would now like to turn our attention to specific provisions embodied in the bill on which the Committee is taking testimony today.

We want to express our strong opposition to H.R. 4882. This bill would subject tax expenditures to the same congressional budget procedures that now apply to the aggregate level of budget receipts. This would be an unwarranted extension of the budget process into an area which, until now, has been the exclusive province of the tax-writing committees.

Under present procedures, Congress enacts a budget resolution each year which specifies an overall revenue floor and also an amount by which new legislation should increase or decrease revenues during the upcoming fiscal year. The budget resolution may also contain a reconciliation provision instructing the tax-writing committees to report legislation amending the tax laws to comply with the budget resolution.

H.R. 4882 would modify the budget process so that each budget resolution would also specify a separate ceiling on aggregate tax expenditures and an amount by which new legislation should change aggregate tax expenditures. Thus, for example, a budget resolution could specify that the tax-writing committees raise revenues entirely by reducing tax expenditures. Alternatively, it could require the tax-writing committees to reduce total revenues with general tax cuts but to increase revenues by reducing tax expenditures. This would involve the budget committees in determining not only the total level of revenues but also precisely how these revenues are to be raised.

We are sympathetic with the underlying intent of H.R. 4882. Strict standards need to be applied to tax expenditures. The trade-offs between spending reductions and special provisions of the tax code need to be considered. To that end, we hope that in the context of these hearings you will consider other, simpler changes in the budget process that will allow consideration of such trade-offs. The budget reconciliation process completed last summer provided an illustration of the restrictions under which we now labor. The Committee on Ways and Means, on a bipartisan basis, intended to lower the income threshold at which unemploy-

ment compensation benefits are subject to tax instead of making some of the spending reductions recommended by the President in the unemployment compensation and AFDC programs. The Gramm-Latta resolution prohibited this action. If it is the will of Congress that these social insurance benefits be reduced, the Committee should have the flexibility to decide how the reductions should take place - namely should we eliminate all benefits for some individuals or reduce benefits partially for those individuals who have substantial amounts of other income.

We oppose H.R. 4882, however, because we believe it would be unworkable in its present form and would lead to much needless controversy over technical details. This controversy would distract attention from the main issues with which the budget process must deal in the next few years--realigning spending priorities and reducing the massive budget deficits that we now face.

Our specific objections to H.R. 4882 can be summarized as follows:

(1) Definition of tax expenditures.--In the Congressional Budget Act, tax expenditures are defined as "those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption or deduction from gross income or which provide a special credit, a preferential rate of tax or a deferral of tax liability." This definition is not very precise, and if H.R. 4882 were enacted, there would be extensive controversy over exactly which tax provisions were tax expenditures and which were not. For example, the recently-enacted Economic Recovery Tax Act contains a new deduction for two-earner married couples designed to reduce the marriage tax penalty. Is this deduction a tax expenditure, or is it just one of several mechanisms in the tax law used to determine the relative tax burdens of different kinds of taxpaying units, like the head-of-household rate schedule which is not now listed as a tax expenditure? Other areas where there are significant definitional problems include capital cost recovery, capital gains, and imputed income. To date, the tax expenditure concept has not been extended to taxes other than

individual and corporate income taxes. Opening up the definition to other areas, such as excise taxes, would generate further controversy.

(2) Measurement of tax expenditures.--Under H.R. 4882, it would be necessary to measure the aggregate level of tax expenditures. This presents enormous technical problems for several reasons. Unlike the budget aggregates--receipts and outlays--tax expenditures are not observable. Budget receipts represent actual cash flows into the Treasury, and budget outlays represent actual cash flows out of the Treasury. These can be measured precisely after the close of the fiscal year. In contrast, tax expenditures represent revenues which are not collected by virtue of special tax provisions. These uncollected revenues are never observed precisely. Hence, estimates of their size are inherently inexact, requiring sometimes controversial assumptions about how taxpayers and the economy will respond to changes in the law. For example, many people believe that taxation of 100 percent of long-term capital gains, instead of 40 percent, would reduce revenues because people would sell their assets less frequently. How, then, do we measure the size of the tax expenditure associated with the tax preference for long-term capital gains?

Even more serious problems arise if it were necessary to estimate aggregate tax expenditures because the various tax expenditure provisions interact with one another in very complex ways. Each tax expenditure item is currently measured by hypothetically deleting only that one item from the tax code and estimating the effect on revenues. When the potential revenue gain from hypothetically deleting several personal deductions is estimated, the total amount is less than the sum of the individual items because of the interaction with the zero bracket amount (standard deduction). When the potential revenue gain from hypothetically deleting several exclusions from income is estimated, the total amount is more than the sum of the individual items because of the interaction with the progressive structure of tax rates. Whenever total tax expenditures have been reported in publications of the Office of Management and Budget, the Congressional Budget Office, or the staff of the Joint Committee on Taxation, these conceptual limitations have always been noted. No effort has ever been



made to estimate a total based on the hypothetical elimination of all tax expenditure items and a retention of all other features of the tax system. Were such a total to be estimated, the component estimates for individual items would be meaningless because they would depend upon the order in which the items were considered in developing the aggregate estimate.

Up to now, these definitional and measurement problems have not led to controversy because nothing very important has depended on how they were resolved. The analytical work has been done by the staffs of the Treasury Department, Office of Management and Budget, Congressional Budget Office and the relevant congressional committees. Under H.R. 4882, however, these issues would become very significant. Whether or not a revenue bill is in order on the floor would depend on their resolution, and much of our time would be wasted in debating arcane issues which are not now relevant.

(3) Ineffectiveness.--Even if these definitional and measurement issues were resolved satisfactorily, an aggregate ceiling on tax expenditures could be easily circumvented. For example, a cut in tax rates would reduce the size of those tax expenditures which take the form of deductions or exclusions from taxable income, as well as some tax credits. The Economic Recovery Tax Act of 1981 had this effect on estimates of tax expenditures for future years. Thus, in a bill which reduced tax rates, Congress would have room to enact new expenditures and still stay within the overall ceiling. Since many tax expenditures have been enacted as part of larger tax reduction bills, history suggests that a ceiling would in fact result in little control.

Our opposition to H.R. 4882 does not mean that we are unconcerned with the proliferation of tax expenditures in recent years, often as a result of Senate amendments to relatively clean House revenue bills. Particularly at a time when budget outlays are being carefully scrutinized and sharply reduced, we should apply similar strict standards to tax expenditures. As Chairman and ranking minority member of the Ways and Means Committee, we intend to be leaders of that effort. In recent years, the Committee has had numerous hearings to evaluate specific tax expenditures, and several of these have led to legislation.

Also, in recent years, newly enacted tax expenditures have frequently included sunset provisions, so that they will be automatically reviewed. We are confident that we can control tax expenditures without radically new budget procedures. The changes in procedures proposed by H.R. 4882 would simply create so many technical and jurisdictional controversies that we would be distracted from the main task before us. More modest changes in budget procedures, as we suggested at the beginning of this testimony, would better serve the purpose of sound public policy.



National Association  
of Independent  
Colleges and Universities

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202/387-7623

December 9, 1981

Congressman Richard Bolling  
Chairman  
Committee on Rules  
U. S. House of Representatives  
H-312, The Capitol  
Washington, DC 20510

Dear Chairman Bolling:

On behalf of the National Association of Independent Colleges and Universities, the American Council on Education, and the National Association of State Universities and Land-Grant Colleges, representing over 1600 public and nonprofit colleges, universities, and associations in higher education, we forward this letter for inclusion in the hearing record on H.R. 4882, a measure to amend the Congressional Budget Act of 1974 by placing a ceiling on tax expenditures in the first and second budget resolutions and the reconciliation process.

A priority concern of our members is the unfortunate mischaracterization of the deduction for charitable giving as a tax expenditure. The Budget Act defines tax expenditures as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax or a deferral of tax liability." The Budget Act then leaves to the Joint Committee on Taxation, the Department of Treasury, and the Office of Management and Budget the task of determining which specific tax provisions fit the definition. We believe that these offices have incorrectly concluded that the deduction for charitable gifts is a tax expenditure. This unfortunate mischaracterization would be compounded should legislation such as H.R. 4882 extend directly or indirectly to the deduction for charitable giving.

The deduction for charitable giving encourages the voluntary transference of funds from private uses to public uses. Should the deduction be eliminated, the resultant loss of charitable gifts would be a public loss of resources, because by law charities must use privately donated funds for public purposes. Thus, in reality the deduction for charitable giving is more properly viewed as an income defining deduction since the funds donated are not available for personal use.

Further, the rationale for defining items as tax expenditures stems from a belief that the purpose which supports the tax provision alternatively could be accomplished by a direct budget outlay. This is decidedly untrue with the deduction for charitable giving. The heart of the deduction is the encouragement of non-governmental, individual initiatives. Direct federal spending in many cases would eliminate the flexibility and diversity which are the hallmarks of the this sector. Further, many of the important missions of the sector would be blocked from direct federal spending because of state and federal constitutional restraints. Moreover, the deduction for charitable giving has been shown to be efficient, effective and fair, yielding over \$1.19 in charitable contributions for every dollar lost to the Treasury.

The removal of the deduction for charitable gifts from the list of tax expenditures, besides being theoretically correct, has practical significance. The tax expenditure list is perceived by some as government spending through the tax code, and as such has been the subject of Congressional proposals to cut back the total revenue loss generated as a result of these tax provisions. A limitation on the deduction for charitable gifts has immediate negative consequences--the reduction of private funds for public purposes. In addition, however, the uncertainty generated by including the



Congressman Richard Bolling  
December 9, 1981  
Page 2

charitable deduction in this debate could produce the same effect by reducing donor certainty as to the tax treatment of their gift. As studies have shown, charitable giving is extremely sensitive to changes in the tax climate.

Indeed, the unintended consequences of the recently enacted Economic Recovery Tax Act, according to studies prepared by the Urban Institute, is to lower the private contribution by individuals by \$ 18.3 billion in current dollar terms over what they would have been under prior law, should past giving patterns be retained. At a time when the federal commitment to many societal needs is being reduced, and the case loads and burdens of the nonprofit sector are increasing and greater voluntarism and voluntary support is being urged, it would seem counter-productive to limit charitable contributions.

In conclusion, the deduction for charitable giving is more properly characterized as an income defining deduction and hence should be eliminated from the list of tax expenditures and should not be subject to the ceilings envisioned by H.R. 4882. We respectfully urge the committee to consider this issue when it begins its deliberations. We would be happy to meet with your staff or provide any additional material the committee may desire.

Thank you for your consideration of this matter.

Sincerely,

Sheldon E. Steinbach  
General Counsel  
American Council on Education

Christine Topping Milliken  
General Counsel  
National Association of Independent  
Colleges and Universities

Jerry Roschwalb  
Director for Higher Education  
Office of Governmental Relations  
National Association of State Universities  
and Land Grant Colleges

STATEMENT OF HON. PETE V. DOMENICI, A U.S. SENATOR FROM THE  
STATE OF NEW MEXICO

Mr. Chairman and members of the House Rules Committee, I appreciate the opportunity to support the concept of gaining control of tax expenditures through changes in the Budget Act. The budget process has come a long way since its inception in 1974. This year it has provided the framework for substantial budget reductions. Even without further spending cuts, Federal spending is now projected to grow at approximately 9 percent for the next three years as compared to the 15 to 17 percent annual growth of the past few years.

At the same time, tax laws have been changed so that the American taxpayer will no longer be forced into higher tax brackets through "bracket creep" as inflation is built into their wages and salaries. The tax changes could never have been achieved had not the Budget process made the spending cuts possible.

Unfortunately, there are still significant areas of Federal policy which undermine these efforts. The unchecked growth in Federal tax expenditures, amounting to 15 percent per year, is one of those areas. Tax expenditures for the period Fiscal 1982 through 1986 are projected to grow at an annual rate of 15 percent. Fiscal 1982 tax expenditures will total \$266 billion not counting \$11 billion added by the 1981 economic recovery tax act. (These numbers are not additive because the 1981 Act also made reductions in marginal tax rates which will lower the overall expense of all tax expenditures. Revised estimates will be available in the President's 1983 budget submission.) Of \$748 billion of tax reductions contained in the 1981 Act for Fiscal Years 1981 through 1986, \$219 billion are attributable to tax expenditure increases. That equals 29 per-



cent of the total revenue loss. The budget reductions for Fiscal Year 1982 through 1984 under the 1981 Reconciliation Act equaled \$130 billion. This compares with \$280 billion of tax reductions under the 1981 Act for the same 3 year period; \$82 billion are for increased tax expenditures. So, in effect, just counting tax expenditures alone we gave away 63 percent of the reconciliation savings by increasing tax expenditures. This is an example of how difficult it is to control Federal spending and balance the budget. Including tax expenditures in budget resolutions would help achieve these goals.

The effect on the deficit is not the only concern we should have when we discuss tax expenditures. Many tax expenditures also have adverse economic effects, such as increasing inflation and interest rates and reducing economic efficiency. The consumer interest deduction encourages approximately 20 percent of America's taxpayers to make consumption expenditures on credit. Most of these taxpayers have above average income; so why should the majority of taxpayers subsidize them? The deductibility of employer health insurance costs leads to so called "full coverage" health insurance plans which promote over-use of medical services and rapidly rising health care costs. The use of tax exempt bonds has been turned over to some of our most profitable corporations to build new retail outlets. This drives up interest rates and leaves equally worthy small businessmen to fend for themselves.

The present tax expenditure budget does give rise to questions of definition and measurement. One's definition of a tax expenditure depends crucially upon the assumption of what is a "neutral" tax system. The Budget Act defines a tax expenditure as "a special exclusion, exemption, or deduction from gross income of which provide a special credit, a preferential rate of tax or a deferral tax liability." The present tax expenditure budget, for example, excludes business meal and travel expenses in excess of ordinary and necessary expenses of conducting business. On the other hand, it includes accelerated depreciation in excess of straight line even though economists are agreed that true

economic depreciation would exceed straight line depreciation given today's inflation rate.

Despite these difficulties, however, there has been a remarkable consistency of definition in the lists of tax expenditures prepared independently by the Treasury Department and the Congressional Budget Office and the Joint Committee on Taxation. From time to time there have been some differences but in most years the lists have been identical. It would seem to me entirely feasible for a revised list of tax expenditures to be agreed upon by the Executive Branch and Congress, since this has clearly been achieved in the past.

There is also difficulty in measuring tax expenditures. It is true that in many cases it is impossible even long after the fact to calculate precisely the amount of a tax expenditure. However, estimating techniques have been developed by the Treasury Department Office of Tax Analysis and the Joint Committee on Taxation which yield reliable estimates of expenditures. So long as there is agreement among the technicians who produced these estimates I see no reason why the Congress should not accept these estimates as a measure of tax expenditures. In the event that economic conditions change or that new data is revealed I am confident procedures could be devised which would provide an orderly accommodation of revised estimates into the tax expenditure budget.

On the same note, it has been pointed out on many occasions that one cannot add tax expenditures together because of "interactions" with the standard deduction or with taxpayers moving into higher tax brackets. It should be noted that such interactions exist already in the budget, for example, among different welfare programs where a change in one program can affect the outlay of another. As long as any tax expenditure ceiling in a budget resolution took into account this effect I see no reason why this problem should preclude appropriate budget controls over tax expenditures.

Tax expenditures are created in many cases with little consideration by the Congress. One significant example of this

is the "leasing" provisions of the 1981 Act. These were barely discussed in the Senate Finance Committee markup and not at all during the House Ways and Means consideration, and yet they became law. The intent was to insure that unprofitable companies such as Chrysler would not be put at a competitive disadvantage because of the increased depreciation deductions. There was also concern that unchecked buildup of unused depreciation deductions would increase corporate takeovers. Since mid-August there has been a steady stream of press reports of the abuse of this provision by very profitable corporations who regularly pay no income tax because of their skilled use of the tax laws. It has also been noted that these profitable companies obtain more tax benefits from leasing than do the struggling companies for which this provision was intended. There are more firms "selling" deductions than there are buyers, so the struggling companies sell their tax deductions cheaply or not at all. The lawyers and accountants who arrange these deals extract their share as well. In the end the benefits to the economy from leasing shrink while the cost to all taxpayers rises.

Another feature of the way tax expenditures are created or expanded is that these provisions are often added to tax bills with so-called "phase-in" provisions which hold down the revenue loss in the early years and then allow these costs to rise significantly in later years. For example, the 1981 Act adds \$11 billion of tax expenditures in 1982. This rises to \$42 billion by 1984 and \$79 billion by 1986.

Tax expenditures in many cases are direct complements to related spending programs. Yet the consideration of tax expenditures is often far removed in the Congressional process from the consideration of the spending. It would be appropriate to use the budget process to enable Congress to deal more systematically with tax expenditures and their relationships to the rest of the budget.

Including the total of tax expenditures in the Budget Resolution would help to assure that concerns such as those I have described are systematically addressed by the Congress. Precedents have already been established for enacting non-binding outlay and revenue totals for outyears under the budget resolution and it would be appropriate that the same be done with tax expenditures.

In conclusion, I commend Congressman Bonior for developing H.R. 4882 to achieve control to tax expenditures. Enactment of legislation of this nature would be an important step in regaining control over the budget.

Mr. BEILENSEN. The committee will reconvene at 2 p.m. this afternoon.

[Whereupon, at 11:55 a.m. the committee recessed, to reconvene at 2 p.m., the same day.]

#### AFTERNOON SESSION

[The committee reconvened at 2 p.m., Hon. Claude Pepper, presiding.]

Mr. PEPPER. The committee will come to order.

Our first witness this afternoon is Fred Wertheimer, president of Common Cause.

Mr. Wertheimer, we are very pleased to have you. We welcome your statement.

#### STATEMENT OF FRED WERTHEIMER, PRESIDENT, COMMON CAUSE

Mr. WERTHEIMER. Thank you.

Mr. PEPPER. You know our policy. If one has a written statement, he can either present it or put it in the record and summarize it.

Mr. WERTHEIMER. I would like to put it in the record and summarize parts of it.

Mr. PEPPER. Without objection, it will be received.

Mr. WERTHEIMER. We appreciate this opportunity again to present our position on tax expenditures as the committee considers the budget process and what kinds of changes may be appropriate.

We believe it is very important to devote special attention to this area. We would like to recognize Representative Bonior, the sponsor of H.R. 4882, for his special efforts in bringing this issue to the attention of the committee.

This Congress, as all of us are aware, has been marked by long and extensive debate about the levels of spending which are appropriate for the Federal Government. Yet, in the midst of unprecedented reductions in Federal spending, the fastest growing type of Federal spending has largely escaped the careful scrutiny of the administration and of Congress.

We have had \$36 billion in cuts in direct spending and loan programs, with virtually no attention being devoted to Federal tax expenditures. Not only were \$266 billion in tax expenditures left completely untouched, but in fact the Economic Recovery Tax Act of 1981, added billions of dollars of new tax expenditures.

As so often happens in tax legislation, Congress became the scene of a bidding war in which special interest groups became the ultimate victor. The increases in tax expenditures in the Economic Recovery Act raise projected 1982 tax expenditures to a total of \$279 billion, which is the equivalent of 40 percent of the \$695 billion in direct spending this year.

The increases in tax expenditures enacted in 1981 are by no means unusual. These preferences have been a major growth area.

Mr. PEPPER. Would you give me the figure again? What is that, for 1981, 1982 or 1983?

Mr. WERTHEIMER. It is 1982 tax expenditures.

Mr. PEPPER. How much was that?



Mr. WERTHEIMER. \$279 billion, which is roughly 40 percent of the \$695 billion in direct spending.

Mr. PEPPER. That is the amount of the direct spending?

Mr. WERTHEIMER. That was the initial amount. That is when we started off.

Mr. PEPPER. Thank you very much.

Mr. WERTHEIMER. As we all know and have just seen just by reading the papers recently, the numbers and the problems in terms of trying to figure out what the Congress does with the Federal budget are only going to get much more difficult as we go into next year.

This process of growth in the tax expenditure area has been going on for years now. Since 1975 revenue losses resulting from tax expenditures have risen 14 percent a year, outpacing the 11 percent annual increase in direct spending.

Between 1980 and 1981 alone, tax expenditures grew nearly 20 percent. In 1968, there were 40 or 50 separate tax expenditures. Today there are over 100, and I am sure that record has been made here.

We have seen a very, very large growth in tax expenditures. We have seen the budget, the issues of the budget, become more and more important and tougher and tougher to deal with.

To date we have seen the tax expenditure area simply not systematically reviewed. Our feeling is that the explosive growth in tax expenditures is due in part to the failure of Congress as an institution to give serious and coordinated consideration to this form of Government spending.

I think everyone knows that the process that spending programs go through—an authorizing process, an appropriation process, an overall budget review, in a number of cases authorizations for a specified period of years—invalue the requirements for review.

There is, however, no comparable system for congressional consideration of tax expenditures. In most cases there is no periodic authorization, and there is rarely an evaluation of performance.

Despite the differences in congressional consideration of tax expenditures and direct spending programs, there is very little difference in their impact when Congress and the country have to face up to the ultimate question of how much money do we have and how much of it is going to be spent.

Both types of Government activity are designed to accomplish specific goals. Both cost the Federal Government money, spending programs directly, and tax expenditures indirectly, through revenues foregone. Both contribute to the national debt; reducing revenues through tax expenditures adds to the Federal deficit as surely as direct spending does.

It is our feeling that it is very important at this stage that the privileged status of tax expenditures comes to an end. Institutional changes are needed. One of the most important of these changes, in our view, is found in Representative Bonior's bill, which would provide ceilings for tax expenditures in the first and second congressional budget resolution.

If Congress is to determine the parameters of Federal spending and Federal revenue raising efforts, the budget process must provide an examination of indirect spending through the tax system.



This, we think, is a very significant step, and we would urge this committee to take it.

We also believe that two other important steps are equally necessary. First, that we have greater coordination between what is being done in the tax system and what is being done through direct authorization programs.

We believe that standing committees of the House and Senate with jurisdiction in these areas should get the opportunity to review them and to be able to comment on them. That does not necessarily mean that they would have the opportunity to take them and to either kill them or amend them or change them.

We have supported the idea of authorizing committees having the opportunity to comment and to look at tax expenditures so we can look at the overall implications. We think that can be done without necessarily giving those committees the right to then have jurisdiction over, above, and beyond Ways and Means, or whatever the tax committee is, and therefore move the bill from one committee to the other.

The second is something that we have testified on here before.

Mr. PEPPER. Excuse me. I was just thinking about this. Did the Budget Committee have authority to delete a tax expenditure or would it have to go back to the Ways and Means Committee?

Mr. WERTHEIMER. It would have to go to the Ways and Means Committee, although the Budget Committee, through the reconciliation process, certainly could raise the specific issue.

But our point here would go to the point that if the Ways and Means Committee is considering a tax expenditure that affects housing programs, then it should be done by Congress in some coordinated way with what other housing programs exist. That is not going on now, whether it is housing or any other area.

The result is, once again, that more careful attention is paid to the authorizing programs. I would not want to overstate that case because we have raised our concerns about the oversight process.

Far less attention is paid on the tax side, and what it means is people who are interested in these programs very quickly come to understand that the easiest and most effective way of accomplishing your goals is going through the tax system, where once you pass the program your chances are much better that it is not going to be reviewed. There is no real control on how large the expenditure is because it is left up to those who are using the tax expenditure to determine how much it is.

So for example, on the so-called leasing provision that just passed in this last tax go-round, it appears that the costs of that program in forgone revenue may well exceed all of the budget cuts that this Congress made in this year.

In one tax expenditure everything the Congress did may go out the window from the standpoint of whether you are making any impact on the deficit. That is not a very healthy situation, if Congress is taking on responsibility for the budget as a whole.

Ultimately, we continue to believe that sunset is needed for Government programs and for the tax system in a periodic way over a 10-year cycle, so that there can be a system for reviewing everything.

We think that it will give the Congress the best shot ultimately for both getting effective oversight and for making in a realistic way the tradeoffs that are occurring all the time now when the Congress is deciding to make certain cuts, but not to change other kinds of programs.

Thank you very much, Mr. Chairman. I would be happy to answer any questions.

[Mr. Wertheimer's prepared statement follows:]

TESTIMONY OF  
FRED WERTHEIMER  
PRESIDENT  
COMMON CAUSE

on

H.R. 4882  
before the  
HOUSE COMMITTEE ON RULES

Thursday, 10 December 1981

Mr. Chairman and members of the Committee, Common Cause appreciates this opportunity to present our views on the issue of tax expenditures -- those revenue losses which are attributable to provisions of the federal tax laws allowing a special exclusion, exemption, or deduction from gross income or providing a special credit, preferential rate of tax, or a deferral of tax liability. As this Committee considers changes in the congressional budget process, we believe it is very important to devote special attention to congressional review of tax expenditures. We would particularly like to recognize Representative Bonior, the sponsor of H.R. 4882, for his efforts in bringing the issue of congressional oversight of tax expenditures to the attention of this Committee.

This Congress, as members of the Committee are all too painfully aware, has been marked by long and extensive debate about the levels of spending which are appropriate for the federal government. Yet in the midst of unprecedented reductions in federal spending, the fastest growing type of federal spending has largely escaped the careful scrutiny of the Administration and Congress. While cuts in direct spending and loan programs in the last eleven months have totalled \$36 billion, virtually no attention has been devoted to federal tax expenditures.

When the Administration announced the specifics of its economic recovery program earlier this year, the Director of the Office of Management and Budget announced that the thundering herd of sacred cows had been reduced to a handful. But when it came to tax expenditures, the Administration was much less successful in rounding up the strays. Not only were \$266 billion in tax expenditures left completely untouched by the Reagan Administration's budget proposals, the Economic Recovery Tax Act of 1981 authorized an additional \$13 billion in new tax expenditures for fiscal year 1982. As so often happens, Congress was the scene of a great bidding war, with special interests -- not the public interest -- the ultimate victor. OMB Director David Stockman has said, "Do you realize the greed that came to the forefront? The hogs were really feeding. The greed level, the level of opportunism, just got out of control."

The increases in tax expenditures in the Economic Recovery Act raise projected 1982 tax expenditures to a total of \$279 billion -- the equivalent of 40 percent of the \$695 billion in direct spending allocated for the entire 1982 federal budget. Included in the package were new tax expenditures worth \$11.7 billion to oil companies over the next five years, \$3.3 billion to the savings and loan industry over the next three years, and an estimated \$356 million to trucking companies through FY 1986. Perhaps the most notorious of these new tax expenditures is the provision former Internal Revenue Commissioner Sheldon S. Cohen has labeled the "rent-a-deduction" program, which allows corporations to sell tax losses to other profitable companies to reduce tax burdens. Former Commissioner Cohen has estimated that this one provision alone will cost the Treasury \$58 billion by 1986.

The lack of Administration and congressional attention to tax expenditures has produced the following:

- \*Government spending to subsidize housing for low-income families was reduced for 1982, but tax expenditures encouraging home ownership were untouched.

- \*Although children from middle income families will lose eligibility for federally funded lunch programs, tax benefits will continue to flow to corporate employees who lunch at the partial expense of all taxpayers.

\*Federal assistance to conserve energy and develop new sources will be trimmed while oil companies continue to receive tax incentives to produce profitable conventional energy sources.

\*Cutbacks in Urban Development Action Grants will reduce government efforts to stimulate private sector economic development, but Industrial Development Bonds (IDBs), which pursue the same goal by making tax-exempt low-cost financing available to private firms, remain untouched, in spite of evidence that IDBs are used by profitable firms, stretching the original intent of the subsidy.

(These examples and other portions of this testimony are drawn from a recent Common Cause study, entitled The Untouchables, which is attached.)

The increases in tax expenditures enacted in 1981 are by no means unusual; these preferences have been a major growth area in federal spending policy over the last decade. For example:

\*Over the past ten years, tax expenditures have increased by 343 percent.

\*Since 1975 revenue losses resulting from tax expenditures have risen 14 percent a year, outpacing the 11 percent annual increase in direct spending.

\*Between 1980 and 1981 alone, tax expenditures grew nearly 20 percent.

\*In 1968 there were 40 separate tax expenditures; today there are over 100.

\*The new \$13 billion in tax expenditures added to the 1982 budget will grow to \$88 billion in revenue losses to the 1986 federal budget if left untouched over the next five years.

\*The Joint Committee on Taxation estimates that by FY 1986 tax expenditures will drain \$553 billion from the Treasury, more than doubling the loss in FY 1981 and amounting to 50 percent of that year's federal budget.

The explosive growth in tax expenditures is due in part to the failure of Congress as an institution to give serious and coordinated consideration to this form of government spending. Proposals to establish new federal direct spending programs, for example, receive fairly careful congressional consideration. Standing committees with expertise in a given subject area approve authorizing legislation. The appropriations committees weigh conflicting demands and provide funding for authorized programs. All of these decisions are made within the confines of the budget process.

There is, however, no comparable system for congressional consideration of tax expenditures. There is no periodic authoriza-



tion in most cases: the tax law contains no statement of objectives, and there is rarely an evaluation of performance. There is no review as part of the appropriations process; most tax expenditures are self-executing and require little or no funding for implementation. And as Senator Kassebaum (R-Kan), a member of the Senate Budget Committee and a leader in the fight to bring tax expenditures under control, has written:

I would suggest that the most discouraging aspect of our otherwise commendable effort to fulfill the Senate's budgetary responsibility has been our inability to exercise effective control over the revenue-raising side of the budgetary process. While we have made great progress in our ability to monitor and regulate direct spending, our progress in coming to grips with issues relating to taxation has been practically nonexistent.

Despite the differences in congressional consideration of tax expenditures and direct spending programs, there is little difference in their effect. Both types of government activity are designed to accomplish specific goals. Both cost the federal government money -- spending programs directly and tax expenditures indirectly, through revenues foregone. Both contribute to the national debt; reducing revenues through tax expenditures adds to the federal deficit as surely as direct spending does. As Representative Sam Gibbons (D-Fl) has observed, "These tax expenditures are as much a subsidy to the taxpayer as if the government had written a check to the taxpayer out of the taxes it collected."

Tax expenditures are often promoted by groups and organizations which are unable to secure direct federal funding for their programs. As long ago as 1959, economist Walter Heller observed:

The back door to government subsidies marked 'tax relief' is easier to push open than the front door marked 'expenditures' or the side door marked 'loans, guarantees and insurance' . . .

The very groups that use this back door are often among the most insistent advocates of responsible and informed government budgeting. Yet here is a whole catacomb of government benefits which are largely hidden from public view, let alone, periodic review.

Once embedded in the tax structure, the preferential provisions are treated as inalienable vested rights, impervious to changes in tax rates, economic policy, and technology.

Getting a tax benefit is often better than getting a grant or loan from the government. Once a tax benefit is enacted, there

is a minimal chance of oversight and an even smaller chance that the benefit will be taken away.

Many tax expenditures meet legitimate public policy objectives in a cost effective and efficient manner. But we believe that all tax expenditures should be subject to thoughtful congressional consideration and review. Some tax expenditures perform well; others are out of date, inequitable and inefficient. Yet all are essentially shielded from what the Congressional Budget Office calls the "budget visibility and accountability" focused on direct spending and loan programs.

Common Cause believes that it is time to end this privileged status for tax expenditures. Institutional changes must be made to ensure that tax expenditures which are enacted are subject to the same scrutiny as spending programs. One of the most important of these institutional changes is found in Representative Bonior's bill: H.R. 4882 would amend the Budget Act of 1974 to provide for ceilings for tax expenditures in the first and second congressional budget resolutions -- ceilings that would parallel the spending and revenue targets which are now provided. If Congress is to determine the parameters of federal spending and federal revenue-raising efforts, the budget process must include an examination of indirect spending through the tax system. As Representative Bonior has noted, the present process is a "one-armed wheelbarrow" - tax expenditures must be part of the process if Congress is to be a full partner in preparing the federal budget.

Beyond these important changes, Common Cause believes that two other steps must also be taken if Congress is to control tax expenditures effectively. First, standing committees of the House and Senate with jurisdiction over direct spending programs should automatically review proposals for new tax expenditures affecting their areas. The present lack of involvement and analysis by the standing committees regarding tax committee proposals impedes any effort to coordinate federal efforts in a given policy area. Providing automatic review of proposed tax expenditures by these committees would give the Senate and House an opportunity to assess tax proposals in light of direct spending programs, determine

whether efforts in both are complementary or conflicting, and decide whether, when taken together, these direct and indirect spending programs exceed the amount of resources that should be devoted to a particular activity. This proposal is an important component of Senator Kassebaum's tax expenditure control legislation, S. 193.

Second, tax expenditures should be subject to a sunset process. Once enacted, tax expenditures generally become permanent fixtures of our tax laws. A Common Cause study (Gimme Shelters) of 1978 tax expenditures found that only about 10 percent of the number of tax expenditures (comprising 3.2 percent of the dollars spent through the tax expenditure budget) are authorized by tax provisions that are not permanent. The automatic termination of existing tax expenditures -- and a ten year limit for any new tax expenditure -- should be required to ensure congressional evaluation of actual performance. A periodic review and reconsideration of tax preferences is needed to assess whether the tax expenditure has met its goals, needs to be adjusted or altered, or should be terminated.

As this Committee knows, Common Cause has been a strong advocate of a sunset statute which would apply to federal spending programs as well as tax expenditures. Such a comprehensive approach would force Congress to consider and evaluate total federal spending efforts -- direct spending and tax expenditures -- within specific policy areas.

At the end of 15 years of service as Comptroller General, Elmer Staats reported, "While many . . . tax expenditures help to implement important public policy goals, I can only urge that the Administration and Congress subject tax expenditures to the same careful scrutiny afforded direct expenditures." As each federal dollar is squeezed tighter and tighter and with ever-increasing estimates of future budget deficits, the President and Congress can no longer afford to ignore the rising costs of tax expenditures. We urge this Committee to take steps now to bring these heretofore untouchables under control.

Mr. PEPPER. Thank you, Mr. Wertheimer. We appreciate your lengthy statement.

Mr. Bonior?

Mr. BONIOR. Thank you, Mr. Chairman.

Thank you, Mr. Wertheimer, for your attention to this issue and your support of the concept and the vehicle for dealing with this fast-growing problem.

Prof. Paul McDaniel was here before you this morning and talked about the issue. He has written on it and is well acquainted with the ramifications of tax expenditures. He said something quite interesting, I thought.

He mentioned that in Canada—of course, it is a different form of government, I understand that—they do a side-by-side examination. In other words, the Cabinet officers and the executive departments in Canada do a side-by-side with direct expenditures and tax expenditures.

I suspect that what you are driving at, in terms of giving the authorizing committee some type of say, I think is wise rather than direct action because, No. 1, I don't think that would fly politically at this point. I think yours is a wise suggestion, and I know it is implicit in Senator Kassebaum's legislation that is pending in the Senate.

I would hope that at some point, through the progression of this issue down through time, that we might be able to get to that point.

Another comment I would like to make is that I think you are quite right on the safe harbor leasing, the sale-leaseback provisions. The estimates on that one is that it may in fact reach a cost of \$30 billion, perhaps even \$40 billion.

As you well point out, we have cut back on that 30 percent of the budget which we do have some say over in this Congress. We have diminished our control by some \$36 billion; maybe more.

One of the problems that I see is the tremendous responsibility that we are giving to the IRS in this whole program. They have had the same staffing levels over there, and yet the programs that they are authorized to deal with have grown, as you and others have pointed out, at a 14-percent rate. It seems to me that we have got to address their concerns and their needs also.

I don't have much else to say other than to thank you for your expertise and your comments on these issues. I think they are well taken, and I think you have presented a good case for dealing with the issue. We appreciate your effort in coming down and letting us know about it.

Mr. WERTHEIMER. Thank you. If I may just add one last point, it is as obvious as can be that if this area is not dealt with, given the fact that Government funds are tightening up, that everyone is going to rush in.

The growth in this area will be much greater in the future than it has been in the past, because it will be the only relatively easy access and the problem is going to get much worse.

Mr. BONIOR. I think everyone who has come before us so far has testified to that, from Bob Giaimo to Stuart Eizenstat to the professors that I have mentioned and our witnesses yesterday. The Ways and Means Committee did oversight, and their activity report



showed last year they looked at maybe only 10 of these tax expenditures.

I would suspect if you looked at some of the other authorizing committees, you would find it perhaps was even less in terms of percentage of activity. Although they don't have direct responsibility for them, they certainly can do oversight and comment on them.

In some areas, as you pointed out, housing and energy, tax expenditures take up a greater share in terms of expenditure dollars than direct expenditures. So there is something that needs to be done in this area, and we thank you for your contribution.

Mr. WERTHEIMER. Thank you. Thank you, Mr. Chairman.

Mr. PEPPER. Thank you, Mr. Wertheimer.

This morning our first witness was scheduled to be the Honorable Thomas A. Daschle. He was not able to be here at that time. Mr. Daschle is here now. We will be very glad to have you testify.

**STATEMENT OF HON. THOMAS A. DASCHLE, A REPRESENTATIVE  
IN CONGRESS FROM THE STATE OF SOUTH DAKOTA**

Mr. DASCHLE. Thank you, Mr. Chairman.

Mr. PEPPER. There has been a request for the privilege of still photography at this time in the committee. Is there objection? If not, permission is granted.

Mr. DASCHLE. I would ask unanimous consent too that the text of my printed statement be inserted in the record.

Mr. PEPPER. Without objection it will be so ordered.

Mr. DASCHLE. Mr. Chairman, having heard your last witness, I strongly associate myself with his remarks and, from what I understand, the remarks made by witnesses earlier. I come before you this afternoon to amplify the feeling that I think exists throughout the House today in strong support of the bill that Congressman Bonior has introduced. I am a cosponsor of the bill. It is a recognition of the fact that there is a growing concern not only about the size of the expenditures with which this particular bill deals but the direct connection that exists between those expenditures and the deficit that is now topping some \$100 billion. As a matter of fact, it was reported this week that the deficit could rise to \$109 billion. We can no longer ignore it. We are giving away the bank. We are giving it away through a kind of spending which we do not even budget. The time has come to include tax expenditures in the budget.

We have to be concerned about the fact that we are increasing tax expenditures at a faster rate than any other expenditure within the Federal budget. In 1968 the total amount of Federal tax expenditures was only \$44 billion. In 1975 it had increased by 100 percent, \$88 billion, but this year it is now estimated, as you heard, to be more than \$270 billion, and the types of loopholes, the types of tax expenditures that are now being passed become even more outrageous as we go from year to year.

This year there is no question about the fact that the buy-a-tax-break plan that has obtained the most amount of attention. That tax break plan is going to be two or three times as expensive as we originally perceived. One reason why it is more expensive is simply because we did not put any kind of budgetary limitations, any ceil-



ing upon the amount by which that expenditure should be used. Already this year since the tax bill passed it is estimated that this single tax expenditure has cost us some \$6 billion.

The consequence of all this has been and will continue to be a growing deficit. I was given a statistic that was most interesting. If the cost of these tax expenditures had increased 250 percent instead of the 500 percent that we have seen since 1968 we would have had a surplus this year of \$47 billion in our Treasury. That fact alone is compelling evidence that indeed we must begin to budget this fast-growing area of Federal expenditures.

If I can find fault with the bill, and I do again reiterate my strong support of the bill, my feeling is that it really does not go far enough. Mr. Wertheimer expressed very eloquently some ways in which this measure could be—

Mr. PEPPER. Mr. Daschle, you or Mr. Bonior, I want to get it clear in my mind. I know what the tax reduction was. It is \$750 billion over a period of 5 years. In the reconciliation resolution, I mean in the last tax bill, how much was the amount of tax?

Mr. BONIOR. If I may answer, Mr. Chairman, \$13 billion this year, but most of that clicks in in the out years, so in 1986 it will amount to roughly \$88 billion.

Mr. PEPPER. So the amount that went along with the tax reduction was about another \$13 billion.

Mr. BONIOR. In 1982, and then in 1986, it goes all the way up to about \$88 billion.

Mr. PEPPER. Thank you.

Mr. DASCHLE. I think the implication here obviously is one that we are not sure. We do not know for sure just what kind of budgetary implications it is going to have. That is all the more reason it seems to me that we begin designing a way in which we can be better able, we can have a greater ability with which to deal with this.

Mr. PEPPER. Excuse me just a minute. Apropos of what you said, then we cut an expenditure of about \$35 billion and we gave away \$13 billion in tax expenditures.

Mr. DASCHLE. That is just in this tax bill.

Mr. PEPPER. That is just for 1982.

Mr. DASCHLE. In this particular tax bill.

Mr. PEPPER. How much was the tax reduction for 1982, about \$38 billion?

Mr. DASCHLE. The total expenditure, the total tax expenditure for the last fiscal year was around \$268 billion I think. You could correct me if I am wrong.

Mr. BONIOR. \$222 billion.

Mr. DASCHLE. \$222 billion last year.

Mr. PEPPER. That takes into account all that we have given in the past?

Mr. DASCHLE. That is right. This is in addition to that.

Mr. PEPPER. Thank you.

Mr. DASCHLE. I would only add, and it goes along with your line of questioning, Mr. Chairman, I think that what we need to do is not only put a ceiling on it, but actually begin to look for ways in which that can be reduced. There are ways. I have introduced two pieces of legislation to do that. One which would reduce tax ex-

penditures by \$16 billion, the other which would allow the President simply to bring forth a plan by which he would reduce tax expenditures in the same way that he has advocated the reduction of all domestic spending. Obviously we need to spread across all segments of society, a level of sacrifice. The President is calling upon all Americans to come forth. It seems to me that those who are benefiting from this type of expenditure certainly ought to put forth the same amount of sacrifice on the magnitude of what the President has suggested, which is 12 percent, and that is what my resolution would do.

Certainly if we are serious about the deficit, if we are going to deal with the fact that we are facing \$109 billion in deficit for next year, the only way that we are going to be able to deal with it effectively, even if we eliminated every domestic program, the only additional way that we can deal with it effectively is by dealing with tax expenditures, and I again reiterate my strong support for the bill.

Mr. PEPPER. Thank you very much, Mr. Daschle. Mr. Bonior, any questions?

Mr. BONIOR. Thank you, Tom, for your support and for focusing the attention of the Congress and the American people on this issue, which seems to be hidden under veils. As you well pointed out, because the deficits are rising this issue will continue to get more scrutiny each and every day as we struggle with these deficits. Your contribution on this early on before other Members have addressed it, is very helpful and I thank you very much for coming.

Mr. DASCHLE. Thank you.

Thank you, Mr. Chairman.

[Mr. Daschle's prepared statement follows:]

PREPARED STATEMENT OF HON. THOMAS A. DASCHLE, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF SOUTH DAKOTA

Mr. Chairman and members of the committee, I appreciate the opportunity to testify on the legislation which has been introduced requiring tax expenditure ceilings to be included in the First Concurrent Resolution on the Budget, the Second Concurrent Resolution on the Budget, and the reconciliation process. The Committee on Rules is to be commended for the decision to promptly hold extensive public hearings on this important legislative proposal.

Mr. Chairman, the Federal budget is floundering in heavy seas of red ink, despite the action taken by Congress to reduce Federal spending by \$37 billion this year, the largest reduction on spending in the Nation's history. Two days ago it was reported the administration now estimates a budget deficit of \$109 billion this fiscal year and subsequent budget deficits of \$129 billion and \$139 billion in fiscal years 1983 and 1984. Earlier this year, the administration estimated budget deficits totalling \$67.3 billion in fiscal years 1982 and 1983 and a budget surplus of \$500 million in fiscal year 1984. Today, the administration anticipates budget deficits totalling \$377 billion, more than one-third of a trillion dollars, for the current and next two fiscal years. These projected budget deficits and continued massive deficit spending are totally unacceptable and it is essential to amend the Congressional Budget Act of 1974 to require the Congress to establish tax expenditure ceilings within the framework of the budget process if fiscal responsibility and accountability are to be restored and reestablished.

Tax expenditures are tax loopholes. Tax expenditures are the revenues which are not collected because of the provisions in our income tax laws which allow a special exclusion, or deduction from gross income, or which provide a special credit, preferential tax rate, or deferred tax liability.

Tax expenditures are also the other kind of government spending. In terms of practical effect, tax expenditures are merely an alternative to direct spending, loans, loan guarantees, and other forms of Federal financial aid and assistance.

Nearly a quarter century ago, Dr. Walter Heller, the respected economist and former chairman of the Council of Economic Advisors to the President from 1961 to 1964, offered the following observation on tax loopholes. Dr. Heller said,

"The back door to government subsidies marked 'tax relief' is easier to push open than the front door marked 'expenditures' and the side door marked 'loans, loan guarantees and insurance. . .'

"The very groups that use this back door are often among the most insistent advocates of responsible and informed government budgeting. Yet here is a whole catacomb of government benefits which are largely hidden from public view, let alone, periodic review.

"Once embedded in the tax structure, the preferential provisions are treated as inalienable vested rights, impervious to changes in tax rates, economic policy, and technology."

Mr. Chairman, Dr. Heller's analysis is as timely today as it was in 1959.

Tax expenditures exist in the shadows of the budget process and fiscal policy. In relationship to importance, tax expenditures are the least examined and least considered component of fiscal policy. Loopholes have been shielded for too long from the spotlight of public and congressional scrutiny.

Because they have been sheltered from scrutiny, both the number and the cost of tax loopholes have increased dramatically. One of the first estimates of the cost of tax loopholes was prepared in 1968. According to this early examination, in 1968, tax loopholes cost an estimated \$44 billion. By 1975, the estimated cost of tax loopholes had increased by 100 percent to \$88 billion. This year tax loopholes will cost an estimated \$266.3 billion, not considering the cost of the tax legislation most recently approved by Congress, the Economic Recovery Tax Act of 1981, which contains such notable features as the buy-a-tax-break provision. And earlier this year, again prior to enactment of the Economic Recovery Tax Act, it was estimated tax loopholes would cost an estimated \$465.3 billion in fiscal year 1986.

One of the consequences of the dramatic increase in cost of tax expenditures is continuing massive budget deficits. Since 1968, the cost of tax expenditures has increased 500 percent. If the cost of tax loopholes had increased by 250 percent, not 500 percent, since 1968, there would be a budget surplus this year of \$47 billion, not a deficit of \$109 billion—a massive deficit which would not be eliminated if Congress eliminated all remaining discretionary spending this fiscal year.

Earlier this year when he unveiled the details of the administration's economic program, David Stockman, Director of the Office of Management and Budget, characterized the administration's program by saying the thundering herd of sacred cows had been reduced to a handful. This description was colorful, but exaggerated because the Administration's economic policy architect totally ignored tax expenditures. There is no more sacred cow than the breed known as tax loophole. To his credit, President Reagan in September proposed eliminating abuses and obsolete provisions in the tax code. I applaud the President for his initiative. The \$3 billion reduction in tax expenditures tentatively proposed by the President, which represents a 1.1 percent reduction in the cost of tax expenditures this year, is a step in the right direction. Closing tax loopholes is fertile ground for reducing the deficit and perhaps the Administration will not merely scratch the surface, but will dig deeper in its effort to eliminate abuses and obsolete provisions in our tax laws.

Tax expenditures can and should be reduced by more than 1.1 percent. Earlier this year, I introduced H.R. 3525, the Tax Expenditure Reduction Act, which when enacted will reduce tax expenditures by \$16 billion. Recently I introduced House Resolution 262 requesting the President to submit recommendation to Congress for a 12 percent—\$32 billion—reduction in tax expenditures this year.

In conclusion, Mr. Chairman, the nation can no longer afford the policy of ignoring tax loopholes. Requiring Congress to establish tax expenditure ceilings within the framework of the budget process is a prerequisite to the full and thorough examination of tax loopholes which can no longer be deferred. I strongly support H.R. 4882, and I encourage the committee to give this legislation its favorable consideration.

Mr. PEPPER. Our next witness is Mr. Rudolph Penner of the American Enterprise Institute. Mr. Penner, would you rather present your statement, either put it in the record, you can summarize it or present it as you wish.



STATEMENT OF RUDOLPH PENNER, AMERICAN ENTERPRISE  
INSTITUTE

Mr. PENNER. Thank you, Mr. Chairman. It is fairly short. I think I will just read it quickly.

Mr. PEPPER. Very good.

Mr. PENNER. I would like to thank the committee for this opportunity to testify.

It goes without saying that special provisions of the tax law providing deductions, tax exemptions, and credits should be constantly reexamined to see whether they are effectively fulfilling their goals. However, placing limits on tax expenditures in budget resolutions is not a logically defensible approach to gaining control over unwarranted loopholes in our tax system. Indeed, it may lead to biased decisionmaking.

The problem is that the tax expenditure concept now in use is inherently flawed as a measurement device. The individual revenue loss estimates associated with individual tax expenditures listed in the budget should never be added up. Such addition is even worse than adding apples and oranges.

Adding up tax expenditures is erroneous because the revenue loss associated with each individual item is computed as though that is the only tax provision changed in the tax system. Eliminating two or more tax expenditures simultaneously can result in a tax revenue gain that either far exceeds or falls short of the sum of the individual estimates associated with the individual items.

I have provided in my prepared testimony some examples of the interaction between them. For example, the revenue gain associated with eliminating the interest deduction on owner-occupied homes was estimated at \$15.6 billion in fiscal year 1980. The revenue gain associated with eliminating the property tax deduction is \$7.3 billion. But if the mortgage interest deduction were removed first, the revenue gain associated with eliminating the property tax deduction would be much less than \$7.3 billion because many more taxpayers would then be taking advantage of the standard deduction or zero bracket amount.

The discrepancy between the sum of the revenue losses associated with individual deductions, as it is often reported in the rhetoric on the issue, and the effect of eliminating them all simultaneously is very large. For fiscal year 1982 it has been estimated, under static assumptions, that the revenue gain associated with eliminating all deductions would be \$62.3 billion, whereas the sum of the individual items is \$81.8 billion or more than 30 percent larger. If the impact of removing the deductions on economic activity was considered, the revenue gain would of course be far less than \$62.3 billion, but it would be hard to get experts to agree on how much less. Unfortunately, this problem arises with any tax change and is not restricted only to estimating the effects of changing tax expenditures.

When you start removing deductions the thing works the other way: the sum of the revenue gains is greater than the sum of the individual items, but to my knowledge no one has estimated that.

I think that focusing on the sum of individual items could lead to biased decisionmaking when you are seeking extra revenues, be-

cause as individual items the estimates of revenue gain might be quite misleading. Eliminating a few small tax expenditures may in fact raise more revenue than eliminating others that appear to be quite large.

But even if that problem is ignored, we are left with numerous other problems resulting from the peculiar nature of the tax expenditure concept. It is an artifact that you have to use very carefully. It is quite different than other concepts used in the budget resolution. Outlays, receipts, budget authority, and the national debt all have precise legal meanings. Tax expenditures do not. They are a hypothetical concept. I did not put the point in my prepared testimony, but you would never know whether you have met the target. It is a hypothesis. It is moneys not raised. The estimates are the result of economists' assumptions. However, you do know what the outlays are. You can count the dollars, you can count receipts, and so on. Those are concrete concepts. A tax expenditure is not.

One peculiarity of the concept is that the basic personal and corporate rate structure appears sacrosanct. Everything is measured using that rate structure as a base. It is assumed that the rate structure remains constant regardless of what is done to tax expenditures. But in the real world, of course, the rate structure and tax expenditures have evolved together.

Because the rate structure is used as a base any change in that rate structure changes all estimates of tax expenditures, and indeed the tax cuts just passed will decrease tax expenditures greatly. But it may be that the easiest way to meet an artificial limit placed on tax expenditures in the budget resolution while meeting an overall revenue target may be to just lower the highest marginal tax rates while raising lower marginal tax rates, and I do not think that result accords with the goals of those advocating a limit on tax expenditures.

But the more fundamental problem is that there is no logical reason to give the basic income tax rate structure sacrosanct status. The tax expenditure concept was invented by people who are strong advocates of a totally comprehensive income tax. The concept thus embodies a certain set of political values that are defensible, but certainly not accepted by all tax experts.

Many economists would like to move our tax system toward a progressive consumption tax and indeed, we have already moved a considerable distance in that direction. If tax expenditures were measured using a consumption tax rate structure as a base, the list and the numbers associated with individual items would look very different from the one that is actually published. Indeed, current law would imply numerous negative tax expenditures, and such a list would be certainly as defensible as the one used today.

Proponents of using a comprehensive income tax rate structure as a base face a special problem in today's economy. The tax expenditure concept now in use makes no adjustment for inflation. Thus, the old ADR depreciation system was said to result in a tax expenditure of \$2.9 billion for corporations in fiscal year 1980. But everyone knows that ADR was inadequate given the high rate of inflation which, in that year, eroded the real value of the deduction relative to the market value of the capital that was wearing out.



The Department of Commerce estimated this inadequacy at over \$16 billion for the corporate sector.

There are many other respects in which the tax expenditure concept fails to adjust for inflation. It can also be noted that there would be no room for a corporate tax in a true comprehensive income tax system. Yet the tax expenditure concept now in use regards the current corporate tax rate structure as a base from which tax expenditures should be valued.

One could go on and on describing problems with the tax expenditure concept. However, I believe that I have said enough to indicate that it is too weak a concept to be enshrined in a budget resolution and its use could lead to perverse results.

Moreover, it seems to me that the setting of revenue targets in the budget resolution has already been somewhat successful in drawing increased attention to special provisions in the tax law. Admittedly not much has been done yet, but as the need for additional revenue becomes more apparent I expect the potential of the budget process to grow if we can keep it working at all. At the moment it is not working. The second resolution is very late and, as now written, contains totally meaningless numbers. I believe strongly that it should be our first priority to get the existing process back on track. We should not be diverted by efforts to encumber the process with additional tasks based on concepts such as tax expenditures which have little logical content.

Mr. PEPPER. Thank you very much, Mr. Penner.

Mr. Bonior, do you have any questions?

Mr. BONIOR. Yes, Mr. Chairman.

Thank you, Mr. Penner, for giving us a different view than what we have received already on this issue. I notice toward the end of your statement you mention that the revenue floors to some extent control tax expenditures and focus attention on them. The problem I have with that is that this argument goes mainly to new tax expenditures enacted after the passage of the budget resolution. It does not deal with existing tax expenditures that are merely assumed in the revenue floors of the resolution itself, so while you may indeed be addressing to some extent a portion of the growth, that which is built into the growth over a period of years from 1968 on is not touched at all, and I think that, in itself, is an inherent weakness that is not addressed by the ceiling.

Mr. PENNER. I do not want to claim that oversight of these so-called tax expenditures has been perfect, in fact far from it. But I really do think that the tax expenditure concept is not defensible. Part of the so-called growth in tax expenditures comes from things that I do not think you would say are relevant to good tax law, indeed may be perverse.

Mr. BONIOR. For example?

Mr. PENNER. The liberalization in depreciation this year was a response to inflation causing the effective tax rate on corporations and other businesses to rise because it eroded the real value of the deduction. Yet that will show up as a huge tax expenditure, mainly because we measure tax expenditures wrongly. That is my basic point, that if you are truly interested in a fair tax system, you would have a fair depreciation allowance. But if you focus on the tax expenditure concept it tells you nothing about fairness.

Mr. BONIOR. If we could somehow—let me make one point, and then you can build on it. The point of the legislation, one of the main themes of the legislation is to force us to focus upon the whole concept of tax expenditures, and by doing so construct a definition or measurability that will indeed take into consideration the synergistic effects and the effects on direct expenditures, the stuff that you are talking about which as I understand it is not a very fair way of computing as far as you are concerned. That is one of the main purposes of the legislation, to force the Congress, to force CBO and others to come up with that which we can live with, and I think we can find something that we can live with.

We had Professor McDaniel in here this morning who testified that he has been working with seven European countries. Seven European countries with different tax structures, languages, concepts, and values. If they can come together over a definition it seems to me that we ought to be able to.

Mr. PENNER. I do not think it is very easy, and I should again emphasize that you and I have the same goals. Certainly the amount of oversight should be increased, and by the way, I have no objection at all to a portion of the Senate version of the bill, which would have the authorizing committees look at special provisions of the tax law in their area. I think that might be a very good idea, but I would not build my increased oversight on the concept of tax expenditures. As I say in the testimony, maybe you could make the estimates better, but still at its foundation it would be a hypothetical concept. The actual numbers you would get would depend very much on the assumptions of whatever analyst was computing them, and that makes it very different from something like outlays where you can actually count those dollars going out.

Mr. BONIOR. You cannot always count those dollars.

Mr. PENNER. Once we define them you can count them.

Mr. BONIOR. Yes; but with entitlements, for instance, it is very difficult to pinpoint the exact dollar amount. We come close, and I suggest that those people at CBO come reasonably close on tax expenditures under the present definition. They are guesstimating how much will be spent each year. They are not exactly right, but we are not dealing with an exact science here. If we were, we could press buttons, I suspect, and we probably would not need you or me anymore probably.

Mr. PENNER. The question is whether the concept can be formulated sensibly.

Mr. BONIOR. During your testimony I think you quite rightfully point out the difficulty in computing the interactions among tax expenditures in arriving at an aggregate. We have had numerous expert witnesses here in the past 2 days who have testified that the problem is not insurmountable.

However, I guess my point is that at the bottom of the page you suggest that a similar problem exists with any tax change, and that does not prevent us from setting revenue floors. Why is that problem different for tax expenditures?

Mr. PENNER. I meant to point out that it was very similar in concept, and often we do not take proper account of either the interaction or the dynamic implications of changes in the tax law. I think, however, that following current procedures we have a test of how

well we are doing. At the end of the year we know what receipts were. We never know what tax expenditures were, and actually taking this one portion of the tax law and putting a limit on it could lead to biased results if you took no account of the interactions whatsoever. Some tax expenditures look very large, viewed as individual items, but if you mix them up with other items, they might not be very large at all, so you would build more bias into it.

I think conceptually the problem is similar between the two, but as soon as you put a limit on this one artificial concept it seems to me that the danger of erroneous decisionmaking would grow.

Mr. PEPPER. Thank you, Mr. Bonior.

Thank you very much, Mr. Penner. We appreciate your coming.

Mr. PEPPER. Our last witness is Dr. Richard Rahn, vice president, U.S. Chamber of Commerce. Dr. Rahn, we will be glad to have your statement.

**STATEMENT OF RICHARD W. RAHN, VICE PRESIDENT AND CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY DAVID E. FRANASIAK, DIRECTOR, TAX POLICY CENTER, AND KENNETH D. SIMONSON, SENIOR TAX ECONOMIST**

Mr. RAHN. Thank you, Mr. Chairman. I would like to summarize my remarks and with your permission have my statement put in the record.

Mr. PEPPER. Very well. Your statement will be admitted in full in the record.

Mr. RAHN. I am Richard W. Rahn, vice president and chief economist for the Chamber of Commerce of the United States. I am accompanied today by David E. Franasiak, Director of the Tax Policy Center, and Kenneth D. Simonson, senior tax economist.

We have been highly supportive of measures to approve the budget process, but we strongly oppose H.R. 4882, a bill which would make tax expenditures subject to the same budget limitations as tax receipts. Specifically, we are opposed to it because we believe it would be highly counterproductive. So-called tax expenditures cannot be defined, cannot be measured, and they are an inappropriate constraint.

First of all in terms of definitional problems, tax expenditures are defined as revenue losses resulting from provisions in the Tax Code which are different than normal tax structure. I ask what is the normal tax structure? Even proponents of the tax expenditure concept are not in agreement of what the normal tax structure is. I have been a tax economist for quite some time, and I have little notion of what a normal tax structure would be. In fact, our definition of normal changes from year to year.

For instance, the graduated tax rates for individuals are not considered a tax expenditure, but the graduated tax rates on the first portion of the corporate tax are considered tax expenditures. Personal exemptions are not considered tax expenditures, but exemptions for the blind and aged are considered tax expenditures.

In terms of measurement problems, the numbers listed for the dollar amounts of tax expenditures are almost completely useless. In many cases the data is not available. It assumes a static view of



the world rather than dynamic, and by that I mean the assumption is that individuals do not change their actions as a result of tax rates or the tax structure. Now we know this is wrong.

Let me give you some examples. Municipal bond interest is considered a tax expenditure. The problem is we do not know how many people hold municipal bonds, what their total interest received is, or what marginal tax rates they are in, so we really have no way of knowing what the actual number is. To say the least that is a gross approximation of the number we put in there.

The provisions are not additive, as Dr. Penner pointed out before me. Let me give you one illustration.

The mortgage interest deduction, which is one of the major tax expenditures, is estimated to be \$25 billion this next year. We say that is a tax expenditure, and that supposedly if we got rid of that we would bring in \$25 billion. Now, let us analyze what would happen if we suddenly eliminated the deduction for home mortgage interest.

A lot of people rather than going ahead and itemizing their deductions would take the standard deduction, zero bracket amount, so you would not get all the tax expenditure right there. In addition, what would the impact on the economy be? Well, we are already suffering a housing depression, and if we suddenly took away that exemption, we know that virtually no new homes would be built, that we would drive down the average home price substantially, that many people would be driven out of their homes, no one would be able to afford their mortgage payments. The result would be that we would have economic chaos at least in that sector which would reverberate through things like home appliances, home furnishings, and so forth. A lot of people would be thrown out of work, and all of this would end up reducing a lot of the Government revenues. I cannot tell you what the precise number would be, nor can anybody else.

Let me give you an even more extreme example, but a very real example. In 1978, the tax on capital gains had reached a maximum of 49.125 percent. We did have a 50-percent exclusion. The Congress that year considered reducing the capital gains tax, and ultimately decided to increase the exclusion to 60 percent, with a maximum of 28 percent capital gains tax. That was listed, that change, as a tax expenditure of \$2.3 billion. Some people from the Treasury came up and testified that the Federal Government would lose \$2.3 billion if you and the Congress made that change. Some of us testified that we thought that was nonsense, it was as likely to gain revenues as lose revenues.

Well, what happened? 1979 was the first full year after the tax change, so we increased the size of the tax expenditure, but rather than Federal revenues going down, they went up by \$1.8 billion, and I understand just yesterday that the preliminary data is now in for 1980 which shows a further increase. So, here we had a case that by increasing a tax expenditure Government gained revenue rather than lost revenue.

Now, I do not claim the capital gains tax is typical by any means, but it does illustrate the problems with the concept, because if you had this kind of limitation, you people could say well, we are going to gain \$2.3 billion, take away the exclusion. Now we

know that would cause a revenue loss rather than a revenue gain, and the evidence is if you increased the exclusion you are likely to have a revenue gain, but again that is just one illustration of the types of problems, and I could go through each tax expenditure, and I think illustrate the problem you have with every one of those numbers.

Finally, the tax expenditure concept is not a really appropriate restraint. When you are trying to measure the impact of Government, the best single measure is the amount of Government spending as a percentage of GNP, and I am afraid that this emphasis on tax expenditures will misdirect congressional attention from spending restraint and trying to reduce the impediments on economic growth. Again, tax expenditures are arbitrary, they are artificial.

Another example. If you decided to eliminate the tax expenditure for the progressive portion of the corporate rate, you could do that by either taking the minimum rate of 17 percent and making that 46 percent, or dropping the 46-percent rate down to 17 percent. Now obviously that would have totally different impact. Those two choices would have totally different impacts on Federal revenues, and on the rate of economic growth.

Another example, the marriage penalty. This past year the Congress, and I think correctly so, reduced the so-called marriage penalty by allowing a certain exclusion. Now this is considered a tax expenditure, but if Congress had gone ahead and said well, married people have the choice of filing as single people, that would not have been a tax expenditure. There is surely no justifiable economic reason for making one a tax expenditure and one not.

This emphasis on tax expenditures already duplicates the budget control exercise. I do agree with Dr. Penner that I think more scrutiny needs to be made, and we have been highly supportive of that. The Congress in the Ways and Means Committee and Senate Finance Committee now on a regular basis does review the Tax Code and the various exclusions, and that is an appropriate function for the Congress. We encourage them to do so and these things need to be looked at, but if you try to put an artificial limit on so-called tax expenditures, what you are going to do is increase the uncertainty in the Tax Code. This increase in the uncertainty that particularly businessmen face will end up in reducing the amount of savings and investment in what we call capital formation. This in turn reduces the rate of economic growth and real per capita incomes.

One of the goals of the Tax Act this past summer was to try to increase the certainty of the tax system by giving hopefully a certainty of what our tax code is going to look like in the next few years. Part of the goal there was to, by reducing the uncertainty, make the investment climate more favorable, so that we get our rate of economic growth up, and that we would reduce the impediments to increasing real per capita income.

Finally, in all honesty I just do not believe the concept has any really intellectual merit, and such artificial tax expenditures are likely to cause a major misstatement of both revenues and expenses and further reduce the rate of real economic growth.

Thank you, Mr. Chairman.

[Mr. Rahn's prepared statement follows:]





Statement  
of the  
Chamber of Commerce  
of the  
United States

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ON: H.R. 4882, LIMITING "TAX EXPENDITURES"

TO: HOUSE RULES COMMITTEE

BY: DR. RICHARD W. RAHN

DATE: DECEMBER 10, 1981

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The Chamber's mission is to advance human progress through an economic,  
political and social system based on individual freedom,  
incentive, initiative, opportunity and responsibility.

STATEMENT  
on  
H. R. 4882, LIMITING "TAX EXPENDITURES,"  
before the  
HOUSE RULES COMMITTEE  
for the  
CHAMBER OF COMMERCE OF THE UNITED STATES  
by  
Richard W. Rahn  
December 10, 1981

I am Richard W. Rahn, Vice President and Chief Economist for the Chamber of Commerce of the United States. I am accompanied today by David E. Franasiak, Director of the Tax Policy Center, and Kenneth D. Simonson, Senior Tax Economist.

I commend this committee for its longstanding interest in improving the budget process. However, I must express opposition to H. R. 4882, a bill which would make "tax expenditures" subject to the same budget restrictions as tax receipts.

The U. S. Chamber has shown a deep and continuing commitment to strengthening the budget process. Our staff worked closely with many members of Congress on drafting and enacting the Budget Act of 1974, and we have testified frequently on budget resolutions and procedures. Our over 200,000 business, trade association, and local and state chamber members have a keen interest in tax and spending control.

However, the U.S. Chamber strongly opposes including "tax expenditures" in any budget resolution. Inclusion of "tax expenditures" improperly shifts the focus of the budget process from tax and spending control to a controversial and artificial mechanism.

H. R. 4882 would require that budget resolutions set "the recommended level of tax expenditures" and "the total amount by which revenues or tax expenditures (or both) are to be changed." Bills reported after adoption of the second concurrent budget resolution would be subject to a point of order if they "would cause the recommended level of tax expenditures so set forth to be exceeded". These changes would apply starting in fiscal 1983, less than a year from now.

#### Definitional Problems

Section 3(a)(3) of the Congressional Budget and Impoundment Control Act of 1974 defines "tax expenditures" as "those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." These provisions are measured with reference to a "normal tax structure for individuals and corporations." Although this definition sounds straightforward, in fact any definition of "normal tax structure" is completely arbitrary, and even

proponents of the "tax expenditure" concept have disagreed on whether certain provisions are "tax expenditures."

Examples of this arbitrariness abound. Graduated rates for individuals are not a "tax expenditure," but graduated rates for corporations are. Personal exemptions for taxpayers and dependents are not, but the added exemptions for blind and aged persons are, as is the tax credit for child and dependent care. Other provisions have been variously classified as "tax expenditures" or as part of the "normal tax structure" from one year to another.

The concept of "tax expenditures" is philosophically rooted in the notion that all income belongs to the government and that only the munificence of government allows us to have the income we produce. Such a notion ignores our historical tradition of individual liberty.

#### Measurement Difficulties

Even if it were possible to agree on a list of "tax expenditures," it is impossible to measure their cost accurately. The cost of a "tax expenditure" equals the number of individuals or corporations using the provision times the amount by which their tax liability is reduced. For many "tax expenditures," either the number of users or the amount of reduction in their tax liability, or both, is unknown. For instance, municipal bond interest is a "tax expenditure" because recipients do not have to report the interest on tax returns. However, data are not available on how many individuals hold municipal bonds, how much interest each receives from his or her holdings, or what tax rate would be applied to those holdings. Therefore the estimated size of the "tax expenditure" for municipal bond interest is grossly imprecise.

The total "cost" of all "tax expenditures" cannot be found by adding up the "cost" of each provision. Eliminating one provision, such as the deduction for home mortgage interest, will cause some taxpayers to switch from itemizing deductions to using the standard deduction (zero bracket amount), thereby eliminating several other deductions which are counted as "tax expenditures." Moreover, eliminating the deductibility of mortgage interest would leave many taxpayers less able to afford to purchase homes, thereby cutting the use of the deduction for property taxes and several other "tax expenditures." Finally, cutting back some provisions may cause taxpayers to switch to another "tax expenditure." For all of these reasons, elimination of one "tax expenditure" would decrease the total for all of them or increase total tax receipts by an amount which differs from the estimated cost of that one provision.

In fact, cutting back on a "tax expenditure" actually can decrease tax receipts in some cases. This can occur if the tightened provision raises taxpayers' effective tax rates to such a high level that they decide it is not worth investing or engaging in that activity. In such cases broadening the "tax expenditure" leads to a rise in revenues. A recent example is the reduction in the maximum tax rate on capital gains from nearly 50 percent to 28 percent in 1978. In 1979, revenues from capital gains increased, contrary to official forecasts. The revenue increase occurred because the rates under prior law had been so high (especially given that these rates applied to

"gains" created solely by inflation) that many taxpayers were discouraged from realizing their gains.

The idea that "tax expenditures" can be measured accurately assumes a world of statics rather than dynamics; in other words, it assumes that individuals do not change their behavior as a result of a change in tax rates or tax structures. Such a notion is intellectually bankrupt.

#### An Inappropriate Constraint

Each of these problems makes a total for "tax expenditures" meaningless. But even if one accepts an estimate, however faulty, for the total cost of "tax expenditures," it is still not appropriate to treat "tax expenditures" like the level of receipts or outlays in a budget resolution. The total amount of direct spending is a proper measure of how much of the nation's output the government uses. In contrast, "tax expenditures" measure how much money the government allows individuals and businesses to keep as compared to some arbitrary standard of a "normal tax system." The level of a "tax expenditure" is at most a rough measure of part of private spending for a given activity. Combining these fundamentally different concepts will obscure, rather than clarify, the government's impact on the economy.

Focusing on "tax expenditures" rather than overall receipts misdirects Congressional attention. For instance, the "tax expenditure" for corporate tax rates below the maximum 46 percent rate could be eliminated either by lowering the maximum rate to 17 percent, the current bottom rate, or by raising the lower rates to 46 percent. Yet these two changes would have opposite effects on tax receipts and on the economy. Obviously, the structure of corporate tax rates should be set in the context of desired tax and economic policy, not for the sake of achieving a certain level of "tax expenditures."

Similarly, Congress chose as part of the Economic Recovery Tax Act of 1981 to provide a partial deduction from earned income for working spouses as a way of reducing the "marriage penalty." This deduction is considered a "tax expenditure." Yet, if Congress instead had chosen to eliminate the "marriage penalty" by allowing couples to file single returns, that would not have been a "tax expenditure." The choice of a limited deduction was made on sound tax policy grounds. It would be unfortunate if Congress were forced into changing the tax structure in such cases merely to fit an artificial "tax expenditure" limit.

Furthermore, any change in "tax expenditures" entails a change in tax receipts. Thus, requiring Congress to limit the total of "tax expenditures" as a form of budget control merely duplicates a budget exercise it already performs by setting the level of receipts.

Finally, requiring Congress to limit, and possibly reduce, the total of "tax expenditures" annually adds to uncertainty as to which provisions of the tax code will be altered or deleted. Such uncertainty is inimical to investment planning and would therefore discourage some capital formation. It also would be at cross purposes with the Economic Recovery Tax Act, which improved taxpayer certainty by setting forth specific tax changes for several years ahead.

In short, the concept of "tax expenditures" has no intellectual merit, and thus any limit on "tax expenditures" is ill-conceived, unworkable, and superfluous. Therefore, we urge that you reject H. R. 4882.



Mr. PEPPER. Thank you very much. We appreciate your excellent statement.

Mr. Bonior, do you have any questions?

Mr. BONIOR. Thank you, Mr. Chairman. I have a couple of questions for Dr. Rahn.

I want to thank you for coming and giving us your viewpoint on this issue and the chamber's position on this issue.

You used as an example the capital gains provision as one in which cutbacks in the rates has actually created or stimulated economic activity, and I guess my point is you can make the same argument for things on the direct-expenditure side of the ledger. There are a lot of us who would maintain that the Economic Development Administration instance and that program contributed to growth in our society. It created jobs and was a good expenditure. Some might take the same position with comprehensive employment training, especially the training part of that provision.

The point is that you argue that cutbacks in capital gains necessarily may not be a good idea in terms of dealing with tax expenditures, but you can make the same argument with direct expenditures, and I think I have tried to illustrate that by referring to the EDA programs.

In terms of the question of uncertainty in the business community, Congressman Derrick has been interested in that issue and has queried the witnesses that we have had before us today and yesterday on that. Again, I think you can make the same arguments on direct expenditures. Take the farmer, for instance. There is certainly no less uncertainty in terms of what the Federal Government offers in the way of programs and what the farmer who is in today's society oftentimes middle-size business and often big business in what he will be able to expect.

It seems to me many of the arguments you have made against the concept can be directly applied to the direct end of the ledger dealing with direct expenditures. It just seems to me that when you have a situation where we ask only a portion of our people to bear the heavy brunt of our cutbacks in maternal and child health care, nursing assistance, low-income assistance, social security, I can go on and on. A situation in which Senator Pepper and I, in about 15 minutes, will be asked to go down there and whack another 4 percent off programs for these people, it seems to me it is incumbent upon us in terms of just plain basic fairness to look at the other side of expenditures that numerous reports have shown benefit the upper-income groups in our society, and that they be required to make some sacrifice. These need not be in the areas that will stifle growth, I agree with you there, but in areas where we really have not looked, at expenditures on the tax side which may in some instances be antiquated or not working at all.

You alluded to the fact that the tax-writing committees have reviewed these expenditures, but I would suggest that they have not done it. That is not necessarily their fault. They are overburdened. They have a difficult time getting to all these issues, especially with the present budget situation that we find ourselves in. In fact, the last activity report of Ways and Means showed that only 10 of over 100 tax expenditures or 90 tax expenditures were reviewed. It is not a very good percentage, and it would seem to me that the



proposal that we are suggesting and offering would force the Congress to review them a little better and a little closer and a little more equitably.

Mr. RAHN. I agree with you in terms of the direct expenditures. Some have positive effects on economic growth. Others have negative effects.

Mr. BONIOR. Would you agree that with regard to tax expenditures, some have positive and some have negative effects?

Mr. RAHN. Sure. Direct expenditures you hold hearings and you debate those and sometimes I agree with you, sometimes I do not, but we come to a resolution. But the thing is if I have an artificial limit on the amount of tax expenditures in a year, and again I agree with you that we ought to review each of the exclusions in the tax code and our rate structures and the various things we have in the tax structure. As Dr. Penner said, I do not think we have any differences in goals; it is a matter of getting to them. Looking at some of the tax expenditures, for instance the exclusion of the social security benefits is listed as a tax expenditure of \$13.7 billion, and I would hate to see that artificially suddenly cut off.

Mr. PEPPER. What was your first point there?

Mr. RAHN. The exclusion of social security benefits is listed as a tax expenditure for \$13.7 billion, and if you suddenly had a limit on that, that might be pushed out. The net exclusion of pension contributions and earnings is listed as a tax expenditure of \$27.9 billion. Now if you had again this artificial limit, what happens if this was suddenly cut off and our people were not able to provide for their retirement?

Mr. BONIOR. We could go on and on, and I have got the list in front of me, too. I do not think anybody outside of the administration was talking about cutting social security benefits, and I think we have pretty well, with the help of the Senator, put that to rest for a while.

Mr. RAHN. But I think this would increase the danger that suddenly some of these things might be arbitrarily cut off without proper evaluation through Senator Pepper's committees.

Mr. PEPPER. What might be cut off?

Mr. RAHN. The exclusion for social security benefits.

Mr. PEPPER. You mean to tax them?

Mr. RAHN. Yes; because that is considered a tax expenditure.

Mr. PEPPER. Would you exclude their payments into the fund from the tax?

Mr. RAHN. My own personal preference is not to change the law currently. I think the social security benefits ought to be excluded. That happens to be a personal judgment of mine, but I would surely hate to see the thing cut off arbitrarily and not go through the process that you now go through.

Mr. BONIOR. How about the sale-leaseback provision?

Mr. RAHN. Yes; we would be in favor of that, but again the Congress is looking at it. It is totally appropriate for the Congress to look at it, and the way the Ways and Means Committee and Senate Finance Committee is looking at it I think is the appropriate way to go. The Congress has set up mechanisms in the committee that Senator Pepper chairs to handle the specific issues, and I personal-

ly and I think the chamber feels that that is the appropriate way to do it.

Mr. BONIOR. Secretary Regan a little over a week ago said that "we were rather proud of the sale-leaseback provision." Do you agree with his statement?

Mr. RAHN. I surely do. To me it has been one of the most cost-effective ways of insuring that we get higher employment levels. We have a number of distressed industries, particularly in the Northeast and upper Midwest, and it is clear that the Congress was going to do something to aid these industries. The question really was what was the most cost-effective way to stimulate new employment, to stimulate productivity growth, and we are involved in a process of looking at these alternatives, and I think this was an innovative and cost-effective approach.

Mr. BONIOR. Let me give you an example and tell me how this is cost-effective. Burlington Northern last year had a net income of \$223 million. They not only paid no taxes because of the tax expenditure provision, but claimed an additional \$36 million from the Treasury through the sale-leaseback provision of the Tax Incentive Act. Now how does that square with your statement?

Mr. RAHN. I cannot answer about Burlington Northern specifically. I do not know why they did not have a tax liability. If they did not have a tax liability it is because of some provisions the Congress had put in the Tax Code.

Mr. BONIOR. Tax expenditures.

Mr. RAHN. Well, when you say tax expenditures I do not know which one or which combination or whatever.

Mr. BONIOR. How about the \$36 million that they reaped through the sale-leaseback? Is that the intent of the legislation, to help people like Burlington?

Mr. RAHN. The intent of the legislation was to help both small and big business which was basically on the ropes for a good number of reasons.

Mr. BONIOR. Can you give me an example of some of the small businesses that has helped?

Mr. RAHN. I cannot right off the top of my head. We can bring you in a list and we have many small businesses, the vast majority of the chamber's 200,000 business members are small business, and we know that many of them throughout the country have been benefited, and we would be happy to provide you with a number of examples there.

The real question is, Was Congress willing to let both big businesses like Chrysler and International Harvester go under and have the resulting unemployment and so forth? It is clear to me that the Congress is not willing to do that, and have the kind of economic hardship that would entail.

Then the question became what was the best way to try to insure that businesses which have had a particularly difficult time in many cases due to events beyond their control would be assisted in getting over hopefully a short-term difficulty, and given that, I have not seen an alternative proposal which seems to me to cost the Treasury less and provide more benefits than the leasing provisions in ACCS.

The alternative provisions were things like refundable investment tax credits and so forth, which would have been far more costly to the American taxpayer.

Mr. PEPPER. Would the gentleman yield?

Mr. BONIOR. I yield.

Mr. PEPPER. Mr. Rahn, from the viewpoint that you spoke of, that is the point of the desirability of the tax reduction the administration proposed, from the viewpoint of the economy would it have made any difference whether the tax reductions were for the high-income taxpayers or the middle-income taxpayers or the low-income taxpayers?

Mr. RAHN. Well, we know that high marginal tax rates tend to be a disincentive on activity. Let me take something which is often criticized now, but which the Congress overwhelmingly voted for, and that was the reduction in the maximum marginal tax rate from 70 percent down to 50 percent. Now some of the critics have said, well this benefited the rich, but if you go beyond a very simplistic statement like that, and look at the actual effect, the Treasury received very little revenue from tax rates over 50 percent, because again if you are smart enough to be in the 70-percent tax bracket you are smart enough to figure out how not to pay 70 percent. You stop working, you go into tax shelters, you have savings, or whatever. We know if we have higher levels of savings and more savings is provided by larger income folks that this higher level of savings results in more job creation, and the ones who most benefit from this are people without jobs. Now the people in this room are all probably in the middle or upper middle income tax brackets, we benefit more in the first order from that tax rate reduction.

Mr. PEPPER. We only have about 3 minutes to get downstairs.

Mr. BONIOR. Thank you for coming.

Mr. PEPPER. This concludes the hearing on this bill, H.R. 4882. [Whereupon, at 3 p.m., the committee was adjourned.]